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Cleveland, O.

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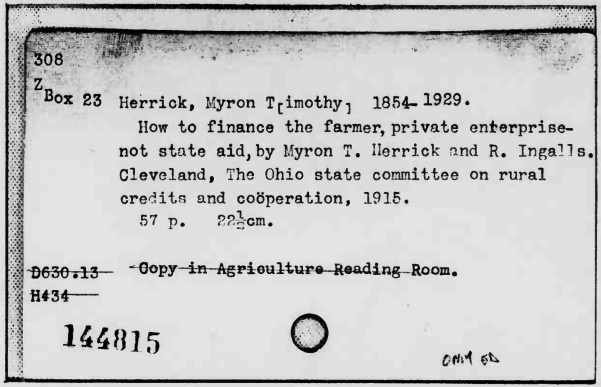

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How to Finance the Farmer

Private Enterprise–Not State Aid

By
MYRON T. HERRICK
and
R. INGALLS

How to Finance the Farmer

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CLEVELAND, OHIO
THE OHIO STATE COMMITTEE ON RURAL CREDITS
AND COÖPERATION
DECEMBER 1, 1915

Printed in the United States of America

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LETTER OF TRANSMITTAL

Cleveland, Ohio,
December 1, 1915.

The Hon. Frank B. Willis,
Columbus, Ohio.

Dear Governor Willis:

I am in receipt of your two letters of November 26 informing me that in pursuance of the authority conferred on you by Laws of Ohio 105-106, 1914-1915, House Joint Resolution No. 38, you have appointed me as chairman and Hon. O. N. Sams of Hillsboro, Ohio, and Hon. L. J. Taber of Barnesville, Ohio, as the two other members of the OHIO STATE COMMITTEE ON RURAL CREDITS AND COÖPERATION.

In accepting this high honor, of which you have kindly deemed me worthy, I would say that I fully appreciate its heavy duties and responsibilities, and that I hope that I shall be able to perform and discharge them satisfactorily to you and to my State.

I note in your letter to me the following clauses:

"It will be the duty of this Committee, in accord with said Resolution, to submit a report on rural-credit conditions within this state, together with suggestions and recommendations as to needed legislation in this field.

"I would also make the additional request that for the benefit of the rural-credits movement as a whole, and with particular reference to conditions in this State, you make a preliminary report descriptive of the institutions or systems for rural credit on which a system for Ohio might be modeled. You will of course have the coöperation of the other members of the Committee in formulating any such report."

I have prepared, with the assistance of Mr. R. Ingalls, and herewith submit, with Mr Sams' approval, the preliminary report that you request. Mr. Taber, however, is in California and has not seen this preliminary report; so we two other members wish it to be considered only as an expression of our personal views, in no way binding on the Committee.

Upon Mr. Taber's return the Committee will meet and formulate plans for action. Without any unnecessary delay it will, in accord with the Resolution, submit to you a report containing the findings of the Committee, together with its suggestions and recommendations as to what changes in or additions to the laws of Ohio should be made, and what other steps should be taken in order to improve rural credits, banking and financial facilities, and to effect the coöperative organization of the farmers of this state.

Very respectfully,

Myron T. Herrick.

HOW TO FINANCE THE FARMER

PRIVATE ENTERPRISE—NOT STATE AID

CHAPTER I

THE RURAL CREDITS MOVEMENT

"It is of great importance to the social and economic welfare of the country that its farmers have facilities for borrowing easily and cheaply the money they need to increase the productivity of their land. It is as important that financial machinery be provided to supply the demands of farmers for credit as it is that the banking and currency systems be reformed in the interest of general business. Therefore we recommend and urge an authoritative investigation of agricultural credit societies and corporations in other countries and the passage of state and federal laws for the establishment and capable supervision of organizations having for their purpose the loaning of funds to farmers."—(*Republican National Convention, June* 22, 1912.)

"Of equal importance with the question of currency reform is the question of rural credits or agricultural finance. Therefore we recommend that an investigation of agricultural credit societies in foreign countries be made, so that it may be ascertained whether a system of rural credits may be devised suitable to conditions in the United States: and we also favor legislation permitting national banks to loan a reasonable proportion of their funds on real-estate security. We recognize the value of vocational education and urge federal appropriations for such training and extension teaching in agriculture, in coöperation with the several states."—(*Democratic National Convention, July* 2, 1912.)

"The development and prosperity of country life are as important to the people who live in the cities as they are to the farmers. Increase or prosperity on the farm will favorably affect the cost of living, and promote the interests of all who dwell in the country, and all who depend upon its products for clothing, shelter, and food. We pledge our party to foster the development of agricultural credit and coöperation, the teaching of agriculture in schools, agriculture-college extension, the use of mechanical power on the farm, and to reëstablish the country-life commission, thus bringing the benefits of better farming, better business, and better living within their reach."—(*Progressive Party, August* 7, 1912.)

These planks in the platforms of the three important political parties in 1912 nationalized the movement for improving credit facilities for American farmers and landowners. The honor of being the first to obtain such indorsement for the movement belongs to Parmely W. Herrick and Mortimer H. Laundon; for these two men, both of Cleveland, drafted the Republican plank and procured its adoption at Chicago ten days before the Democratic party and forty-six days before the Progressive party took any action on rural credits.

The movement had been making headway for a number of years previous to its recognition by the political parties in their national conventions. The National Monetary Commission, created in 1907, had told enough about the German landschafts and the French credit institutions to awaken a desire for more information. The Country Life Commission, appointed in 1908, had shown how the farmers' money was being diverted to city-centered enterprises, and had recommended rural coöperative organization as the remedy not only for their financial but also for their economic and social troubles. With prophetic vision of the present rage for state aid, the Commission ended its report by saying: "Manifestly government in the United States cannot manage the work of voluntary rural organization. Personal initiative and a cultivated coöperative spirit are

the very core of this kind of work." In a special message of February 9, 1909, transmitting the report to Congress, President Roosevelt declared that the first, great, general, and immediate need of country life is co-operation, and asserted that "the farmers of every progressive European country have realized this essential fact and have found in the coöperative system exactly the form of business combination they need."

Since President Roosevelt's message, four distinct factors have contributed to the progress of the rural-credits movement. On October 26, 1910, Group Five of the Bankers' Association of Ohio held at Delaware in that state a meeting in which farm finance and the German landschafts were discussed. Within the twelvemonth following, articles appearing in leading newspapers aroused such widespread interest that on November 24, 1911, the American Bankers' Association at its annual meeting at New Orleans created a Committee on Agricultural and Financial Development and Education, and, after hearing a few remarks on the German landschafts and the French land-credit institutions, decided, at the instance of Ohio members, to study land and agricultural credit at home and abroad.

Thenceforth the movement began rapidly to assume prominence. From the 14,966 banks and trust companies affiliated with the Association, subsidiary agricultural committees were formed in thirty-four states, the first dating from June, 1909, in Minnesota. The activities of their officials exerted a strong influence on subsequent events. On September 12-13, 1912, the Association held at Detroit another conference on rural credits and listened to addresses from two of the members of its committee, Edwin Chamberlain of San Antonio, Texas, and George Woodruff of Joliet, Illinois, and from other speakers who had studied rural credits in Europe. Although the American Bankers' Association reorganized its committee in 1913 and then dropped out of the movement which it had been so instrumental in launching, its good work had made an abiding impression and induced other organizations throughout the country to take up the subject. The first of these was the Chamber of Commerce of Elyria, Ohio, which on January 5, 1912, appointed a committee to study farm finance.

Inspired by the action of the American Bankers' Association at New Orleans, President Taft in March, 1912, directed Philander C. Knox, Secretary of State, to instruct the American Ambassadors to Germany, France, and Italy and the American Ministers to Belgium and the Netherlands to investigate the land- and agricultural-credit systems and institutions of the countries to which they were accredited, and to send copies of their reports to the Embassy at Paris. On the thirtieth of that month the Department of State requested the then newly appointed Ambassador to France to continue the investigation and to prepare a general report from the special reports on the countries named, and advised him that further instructions would be issued to diplomatic officers in other countries where rural-credit institutions were found to exist, the purpose being to "place the Department in possession of all data necessary to the President for the formulation of some practical scheme which may be worked out to bring the desired benefits to agricultural communities in the United States."

During the summer the Government at Washington distributed the information as it was gathered to the public press, and on October 11, 1912, published it in condensed form as the "Preliminary Report on Land and Agricultural Credit." Copies were sent to the governors of all the states with a personal letter from President Taft urging them "to make this matter the subject of their earnest study and exchange of views," and inviting them to confer with him at the next meeting of the House

of Governors. This conference was held on December 7 of that year. The governors appointed a committee to devise ways and means for action, but so far they have made no definite recommendations. The call issued to the governors was the last step taken by President Taft's Administration. The elections of the preceding November had been disastrous to the Republican party in the nation and in most of the states, and his defeat prevented Mr. Taft from maturing the plans he had begun to formulate. Since then the movement has been left largely in the hands of the Democratic party.*

During his candidacy President Wilson was as ardent an advocate of the rural credits movement as his predecessor, and in his inaugural address he declared that agriculture is not "afforded the facilities of credit best suited to its practical needs." An opportunity to promote the movement was already prepared for him. The Agricultural Appropriation Act, approved by President Taft on the last day of his term, carried an amendment proposed by Senator Duncan U. Fletcher of Florida, which provided for the appointment of a commission to work in conjunction with the American Commission assembled by the Southern Commercial Congress for the study in European countries of coöperative land- and rural-credit institutions and similar organizations devoted to improving agricultural conditions. Senator Fletcher's amendment was a modified form of a joint resolution introduced by Senator Asle J. Gronna of North Dakota on February 12, 1912, and adopted by the Senate with a slight change on May 7, 1912. The seven members of the United States Commission thus created and provided with an appropriation of $25,000 were among President Wilson's earliest appointments.

The American Commission consisted of sixty-seven official or volunteer members, representing thirty states and four Canadian provinces. The Southern Commercial Congress began to assemble this commission in the summer of 1912, in accordance with a resolution adopted on April 8, 1912, at its annual convention at Nashville, Tennessee. The same resolution had been adopted two days before at a conference of Federal officials and individuals from twenty-seven states invited by the Southern Commercial Congress to meet concurrently with its convention upon the suggestion of David Lubin, the delegate appointed by the U. S. Department of Agriculture to the International Institute of Agriculture in Rome. The Institute's pamphlet, "Systems of Rural Coöperative Credit," published early in 1912, was made a public document on April 17 of that year on motion of Senator Porter J. McCumber of North Dakota. The free distribution of this pamphlet and the work done by the Southern Commercial Congress in assembling its commission, together with the very large First National Conference on Marketing and Farm Credits held at Chicago under the auspices of farm papers on April 8-10, 1913, stimulated the movement and helped to make rural credits one of the most widely discussed issues that has come before the American people for many years.

The two commissions sailed for Europe on April 26, 1913. The evidence of the American Commission was submitted to the Senate on October 20, 1913, its observations on December 5, 1913, and a minority

* The "then newly appointed Ambassador to France" was Myron T. Herrick. Mr. Herrick selected Edwin Chamberlain of San Antonio, Texas, Edward N. Breitung of Marquette, Michigan, and R. Ingalls of Atchison, Kansas, to help him in his rural-credits investigations. With their assistance he prepared his "Preliminary Report on Land and Agricultural Credit." Mr. Herrick was the principal speaker at the meetings at Delaware and Elyria, Ohio, and at New Orleans, and he introduced the resolution that led the American Bankers' Association to take up the study of rural credits. Parmely W. Herrick is his son, and Mortimer H. Laundon is a member of the executive staff of his Cleveland office.

report on February 11, 1914. The United States Commission submitted its report on January 29 and March 13, 1914. The aggregate expenses of the members of the American Commission, with the outlay of the European nations that assisted them in gathering material, are estimated at $100,000.

In the meantime Congress had started investigations. The House Committee on Banking and Currency created a subcommittee on rural credits that held meetings from December 3, 1913, to February 12, 1914. The Senate Committee on Banking and Currency created a similar subcommittee. The two held joint meetings from February 16 to July 23, 1914. Fifty-one persons were heard. Two of them represented the National Farmers' Union; none of the rest appears to have been accredited by any farmers', mortgage men's, or bankers' organizations; thirty-six were Senators, representatives, government officials, or ex-members of the United States and American commissions. Their testimony fills 1,287 pages, and much of it is repetition of the evidence and conclusions in the reports of the two commissions. The Senate spent $2,323.50 and the House $6,570.29 in conducting the business of their subcommittees.

The Hollis-Bulkley bill (so named from the chairmen, Senator Henry F. Hollis of New Hampshire and Representative Robert J. Bulkley of Ohio) was drafted by the subcommittees and introduced simultaneously in the Senate and House on May 12, 1914. Senator Fletcher, who was chairman of both the United States and American commissions, had already introduced a bill on August 9, 1913, which in its amended form and under the name of the Fletcher-Moss bill is understood to be approved by the majority of the members of the two commissions. All told, eighty-six measures relating to rural credits have been introduced in Congress, including duplicates, resolutions, and the bills providing for the creation and expenses of the commissions and the subcommittees. With few exceptions they relate exclusively to land credit.

On February 25, 1915, a measure called the McCumber amendment passed the Senate, and on March 1, 1915, another, called the Bulkley amendment, passed the House, both as riders to the Agricultural Appropriation bill. The former provided for the establishment in the Treasury Department of a bureau of farm credits, empowered to issue bonds and to continue in existence as long as it "shall be able to dispose of bonds at par." The money raised thereby was to be used by the bureau in buying farm mortgages from national and state banks; and any such bank was to have the right to be declared a purchasing agent of the United States Government for this purpose. Ten million dollars were to be appropriated to start business. The second rider provided for a Federal farm-loan board and a system of semi-public institutions with power to issue bonds in representation of farm mortgages obtained from national farm-loan associations. The Federal Government was to be required to buy an amount of these bonds that might equal $50,000,000 a year.

The two riders were stricken out and replaced by a clause which established a joint committee of twelve members of the Senate and House. This was approved on March 4, 1915, and the committee was organized two days later. It must prepare and submit, by January 1, 1916, a bill or bills providing for a system of rural credits adapted to American needs and conditions. The chairman is Hon. Carter Glass of Virginia. The appropriation for expenses is $10,000.

Other important legislation bearing on rural credits has been enacted by Congress. The Federal Reserve Act contains a clause authorizing reserve banks to discount six-months' agricultural or live-stock paper, and another clause authorizing any national bank (not located in a central reserve city) to invest one-fourth of capital stock and surplus or one-third of time deposits in five-year farm-mortgage loans. Also, the act for reclaiming arid lands was amended. This act, passed in 1902, created the Reclamation Service and set aside for its purposes all except five per cent. of the money to come from the sale and disposal of public lands in sixteen states. This has amounted to $81,813,772.71, and has been used in irrigation projects. The cost, apportioned among the tracts improved, was required to be paid by the settlers in ten annual instalments. In 1914 the period was extended to twenty years. The Reclamation Service has also been authorized to borrow $21,000,000 to complete its work. The settlers are not charged interest. This is one of the greatest instances of government aid for farmers in the world. In the states, laws have been enacted as follows:

ARIZONA.—In 1915, a law permitting the proceeds of state lands to be invested in mortgage loans on farm lands.

CALIFORNIA.—In 1913, a law on mortgage insurance companies. In 1915, a resolution to amend the constitution so as to empower the state to use its cash and credit for a system of land colonization and rural credits.

COLORADO.—In 1915, a law permitting funds derived from certain public lands to be invested in mortgage loans on farm lands.

GEORGIA.—In 1915, a resolution memorializing Congress to pass a state-aid measure known as the "Rural Credits System Bill" pending in the National House of Representatives during the last session.

INDIANA.—In 1913, a law on rural loan and savings associations that authorizes the state auditor to act as trustee for the holders of the bonds of such associations.

KANSAS.—In 1915, a law authorizing building and loan associations to issue privileged rural-credit shares; also a law permitting the owner of a farm mortgage deposited with the state treasurer to issue debentures certified by that official to the effect that the title is perfect and the security ample.

LOUISIANA.—In 1912, a constitutional amendment authorizing the exemption from taxation of lands improved as homesteads by or for immigrants. In 1914, a law permitting the owner of farm lands to issue coupon bonds upon the security of the property without any personal liability against himself. The bonds may be made payable to bearer and registered with the clerk of the county court. The property shall be appraised by a committee of three cashiers of banks in the parish in which the property is situated. Two of this committee shall be appointed by the district judge. The mortgage shall run in the name of the sheriff and provide for a confession of judgment in favor of the future bondholder.

MASSACHUSETTS.—In 1909, a law on credit unions. In 1915, an amendmend of this law to permit the credit unions to issue bonds and make 40-year farm-mortgage loans. Also a law on farm-land banks. Such credit unions and banks are exempt from taxation.

MINNESOTA.—In 1915, an act authorizing an amendment to the constitution so as to permit permanent school and university funds to be invested in mortgage loans on farm lands.

MISSISSIPPI.—In 1914, a resolution memoralizing Congress to pass one of the bills pending in the last session to authorize the United States to borrow upon its bonds money to lend to farmers; also another resolution memorializing Congress to establish a system of land-credit banks with power to issue bonds, circulating as currency, and guaranteed by the United States, for the purpose of raising money to lend on farm mortgages for improving land.

MISSOURI.—In 1915, a special act creating "The Missouri Land Bank," to be managed by the state bank commissioner, under the supervision of a board composed of the governor, attorney general, secretary of state, state treasurer, and state auditor. The bonds of the bank shall be exempt from taxation, guaranteed by the state, and legally used as an investment for public and fiduciary funds. The proceeds of the bonds shall be loaned on mortgages on farm lands. The law appears to be unconstitutional, so the bank has not yet been formed.

MONTANA.—In 1915, an act creating the Department of Farm Loans with the state treasurer as commissioner and the county treasurers as local representatives. The Department may issue bonds in $100,000 series at not to exceed five per cent. interest per annum for the purpose of raising money to lend on farm lands. The mortgages shall be repayable by a semi-annual annuity of four per cent. and exempt from taxation. The mortgagors of each series shall be jointly and severally liable for the defaults of one another. Also a new law on title insurance companies.

NEW YORK.—In 1913, a law on credit unions. These are tax-exempted. In 1914, a special act creating the "Land Bank of the State of New York." This institution is exempted from all taxation, and the state comptroller must serve as trustee for its bonds. The proceeds of the bonds shall be invested in mortgage loans on farm lands.

NORTH CAROLINA.—In 1915, a law on credit unions; these have tax exemptions. Also a law on land and loan associations.

NORTH DAKOTA.—In 1915, a resolution to amend the constitution so that the state may provide for the formation of rural agricultural credit associations and establish a loan fund by pledging its credit, or otherwise, for the purpose.

OKLAHOMA.—In 1915, a law to authorize the state to sell upon long-term mortgages its public lands to settlers undertaking to improve the same.

OREGON.—In 1915, a law on coöperative banks. Also a law on credit unions; these are not liable to taxation.

PENNSYLVANIA.—In 1915, a law authorizing coöperative banking associations to become banks of discount and deposit.

THE PHILIPPINE ISLANDS.—In 1908, a special act creating the government "Agricultural Bank." This institution has been supplied with public funds. In 1915, a law on agricultural credit coöperative associations. These have certain tax exemptions.

PORTO RICO.—In 1915, a special act creating the semi-public "Insular Bank of Porto Rico" for extending credit on farm land and to agricultural enterprises.

RHODE ISLAND.—In 1914, a law on credit unions. These enjoy certain tax exemption. In 1915, a new law on loan and investment companies.

SOUTH CAROLINA.—In 1913, a law permitting banks to invest three-fourths, instead of one-half, of their capital stocks in real-estate mortgages. In 1915, a law on coöperative unions.

SOUTH DAKOTA.—In 1915, a resolution to amend the constitution so as to permit the state or contiguous counties to maintain systems for rural credits and farm-land loans.

TEXAS.—In 1913, a law on rural credit unions.

UTAH.—In 1915, a law on coöperative banks for personal credit. Also a law on coöperative land-credit banks. The state treasurer is required to serve as trustee for the bonds of such banks.

VERMONT.—In 1915, a law exempting mortgages from taxation if they represent the whole or a part of the purchase price of real estate or tangible personal property and do not bear interest to exceed five per

cent. a year. Also a law respecting coöperative savings and loan associations.

WISCONSIN.—In 1913, a law on coöperative credit associations. Also a law on land-mortgage associations; if bonds are issued the mortgages securing the same shall be certified as to value by the assessor of incomes and deposited with the state treasurer as trustee for the holders.

This survey of the laws enacted and proposed discloses a pronounced tendency towards state aid, tax exemptions, and class legislation. In foreign countries government has never intervened by such a use of its cash and credit or special privileges, except where there was a crying need for it. Tax exemptions are a means of encouraging thrift, and are never accorded except with restrictions as to amount. To do otherwise would be wrong, because it would place the surplus of wealth in competition with the savings of the poor, and afford the rich an opportunity to escape paying their just proportion of the expenses of government by investment in tax-exempted deposits, shares, and bonds. The European public or semi-public bureaus, commissions, land-credit banks, funds, and foundations that exist were established for breaking up the feudal or other oppressive systems of land tenure, or for distributing money obtained or appropriated for ignorant and indigent peasants, or for relieving distress occasioned by wars or natural causes, or for meeting problems arising from compulsory military service, absenteeism, city congestion, land reclamation, interior colonization, or political necessities.

In the United States, however, government is now being asked to assist all classes and conditions of farmers. And yet the American Commission, assembled by the Southern Commercial Congress, said in its report that the "problem of rural credit should be worked out without government aid." The United States Commission, which accompanied the American Commission to Europe, in its report asserted that "it is our opinion that such aid should not be extended in the United States." The Secretary of Agriculture, Mr. Houston, stated in his annual report for 1914 that "there is no emergency calling for the use of the Government's cash or the Government's credit," while President Wilson, in his message to Congress on December 2, 1913, boldly declared that "the farmers, of course, ask and should receive no special privilege, such as extending to them the credit of the Government itself."

Public or semi-public establishments are a means for subsidizing rather than for financing their beneficiaries. Investors in the securities of institutions created or assisted by the state look to it, and not to the land or its owner, for the return of their money. Consequently, such institutions have not a true land-credit character, and so their presence, by discouraging private enterprise and by doing away with the necessity of enacting proper legislation, might cause as much harm as good. The organization of land credit depends upon mobilizing land values. For this there must be cheap and easy procedure for proving titles and for recovering defaulted loans, as well as institutions for giving marketability to mortgages or securities based on the mortgages.

The first requirement has been met by Torrens systems in California, Colorado, Illinois, Massachusetts, Minnesota, Mississippi, Nebraska, New York, North Carolina, Ohio, Oregon, and Washington. The Commissioners of Uniform State Laws have drafted a model for a Torrens act, and the prospects are bright for its adoption in other states. But the second requirement is lacking in many states; their real-estate laws are dissimilar and defective in regard to foreclosure and redemptions. The removal of this trouble is as important as the enactment of laws for the formation, management, and supervision of land-credit institutions.

CHAPTER II

THE OLD FARM MORTGAGE CRAZE

The movement for rural credits should have been begun with the peace at Appomattox. The reconstruction work in the South and the rapid settlement of the West after the Civil War increased the demand for money beyond existing supplies, and overtaxed banking and financial facilities. Commerce, industry, and the building of railroads, towns, and cities were given the first attention. Agriculture was overlooked—and at the very time when it was rapidly assuming great international importance.

The extension of railroads, the grants of bounty lands to ex-soldiers, the breaking up of the Southern plantations, and the opening up of the public domain led to a forward movement to the land such as the world had never seen before. The opportunity to get a homestead free from the Government or cheap on mortgage from the original owner was an irresistible temptation. Then came the invention of the reaper, the harvester, and other labor-saving machinery, which on level ground so enlarged the individual power of man as to bring about a complete revolution in agriculture. The smallest area desired for a farm was the quarter section; so the hill country and smaller farms in the older states were abandoned, and the prairies became rapidly settled.

As long as any open range remained the chief aim of the emigrant settlers was to buy machinery and plenty of land on which to operate it. The inordinate demand for land and the rise in the price of exportable products caused an astonishing advance of values in Southern and Western real estate and brought on a fever of speculation. The abandonment of Eastern farms, and consequent travel and transportation, occasioned enormous expenditures and waste. The loss did not stop upon arrival of the settlers in the new regions, because many located without any idea of permanent possession, but simply to hold for a higher price and move farther on. This shifting of the population was bad for both the farmers and agriculture. Coöperation was impracticable in the face of such frequent changes, and among persons of unknown antecedents or without common local traditions, while careless cultivation resulted in reckless robbing of the soil.

But there was apparently no need of provident or scientific methods, because it was the day of the single crop—cotton, corn, wheat, or cattle—when the land yielded the abundance of its pristine fertility. Peasants in the old world were utterly unable to compete in growing any of these staples with the American farmers aided by nature and machinery. The United States became dominant in their markets, and brought on a crisis in rural Europe, but only temporarily. Most of the afflicted countries quickly overcame their disadvantage by the use of fertilizers and by improved and more intensive cultivation; by the practice of long-term mortgaging, which lightened the debt burden of the peasantry; and above all, through the introduction of coöperation, which enabled the peasants, poor though they were, to combine their resources, acquire modern implements and machinery, and adapt themselves to the new order of things.

While this readjustment was going on in Europe, American agriculture continued without thought of the future. The farmers were unorganized and unthrifty. Each man was for himself. In his new location the settler held as large a farm as he could operate with machinery, and,

with but guesswork knowledge of what the soil was fit for, raised only those crops which had a foreign market, regardless of the needs of his own country. He bought his farm on mortgage and built his new home and made improvements in the same immethodical way. He borrowed money to purchase live stock and equipment, put off payment for his expensive machinery and household necessities from harvest to harvest, and trusted to the continuance of good times and high returns to enable him to meet his obligations.

Credit was extended by country-store merchants and implement dealers, and cash loans were made with deposits and savings by commercial banks, brokers, and companies, most of whom were tempted by fat fees, usurious interest, and the gullibility of investors. The charges to the borrower were heavy, but the credit was easy so far as the amount was concerned, and so was lavishly used. In Kansas and Nebraska this was particularly the case, and led to injudicious development far out in the semi-arid regions where the weather always is precarious. The seasons during the first years, however, were unusually fine and transportation was not available for the bumper crops which were harvested.

Then from various economic causes the prices of commodities began to fall. Perhaps the chief cause was overproduction, the result of contemporaneous development throughout the world of land and sea transportation, refrigeration in steamships, and the use of machinery in the fields of Russia, South America, and Australia. The downward fluctuations in the West of the United States reduced wheat to 45 or 50 cents a bushel, corn to 13 or 14 cents a bushel, and cattle to 3¼ cents a pound. These prices were lower than the costs of production. Coal was 29 cents a bushel at the railroad, so the "sod-busters" on the prairies ploughed under their fodder and burned their grain for fuel. The fever of speculation suddenly subsided. All the credit was short-term; even the real-estate loans ran only three or five years. When it was called during the agricultural and financial depression which followed, the Western farmer was found to be inextricably involved in debt to an unsympathetic system that had exploited his hopes and ambitions with as little regard to the consequences as he had given to them himself.

Financial conditions in the West became alarming. The Democrats believed that they were due to a deficiency in per capita circulation, and advocated the free and unlimited coinage of silver at the fixed ratio of sixteen to one. The Farmers' Alliance, the Grange, Grangers, Patrons of Husbandry and Agricultural Wheels suspected "that the large amassed fortunes in the East were being used through brokers and loan companies to procure mortgages on their homes with the intention of dispossessing them at forced sale, and by this insidious process to convert the South and West into a land of lords and tenants, as in Ireland." So they directed their attacks against the trusts and capitalists, and clamored for the suppression of grain elevators and the establishment in their stead of subtreasury warehouses for farm products. The People's party, which adopted and then outstripped these notions, declared the country to be "on the verge of political, moral, and material ruin," and proclaimed an upheaval of society and a complete reformation of government. The legislatures and the courts in some of these Western states were imbued with this revolutionary spirit. In 1891 Texas passed a law preventing aliens from acquiring any title to real estate within its borders. This drove out nearly all the mortgage companies, because none that had an alien among its stockholders could take property under foreclosure. In Kansas and Nebraska, Populist judges refused to render judgments against defendant farmers whom they thought had defaulted

through no fault of their own. In 1893 Kansas passed a stay law that postponed foreclosure for three and one-half years after default.

This groping in the dark and error of opinion were not strange, because at that time agriculture, both as a science and as an industry, was in its experimental stages in the United States, while investigation had not yet brought to light the serious defects in currency and banking that had intensified financial trouble at every disturbance. The real causes and the proper remedies of the agricultural difficulties, however, are now plainly evident. If the farmers had been organized coöperatively, they certainly would have avoided many of their errors and troubles. The absence of coöperation and the practice of single-crop farming and short-term mortgaging had much to do with the crash in 1893 of the farm-mortgage craze.

The mortgage business which eventually expanded into this craze kept pace with the development of the country, reaching Illinois in the fifties and passing the Mississippi River between the fifties and the sixties, and the Missouri River about the eighties of the past century. It was started by excellent men under favorable auspices. In 1849 Benjamin Lombard went from Massachusetts to Illinois, and five years later began to make loans in that state for eastern investors. About the same time Quaker farmers of Chester and Delaware counties, Pennsylvania, were lending money in the West through agencies established for that purpose. The founder of the firm of George W. Moore & Company, of Hartford, Connecticut, was selling to his New England friends farm mortgages from near Chicago in 1856, when he had to travel west from Buffalo by stage.

Austin Corbin—later famed as the founder of the first national bank in the United States and the builder of the Long Island railways—went, in 1851, from New Hampshire to Davenport, Iowa, with the intention of practicing law. In 1852 he formed the banking firm of Macklot & Corbin, and through the aid of his former partner, Governor Ralph Metcalf, of New Hampshire, and other New Englanders, he obtained large amounts of eastern money for investment in farm mortgages and other securities in the Middle West. The railroads were just beginning to be built through that section. The Mississippi & Missouri and the Chicago & Rock Island were extending their lines through the South and West; in 1856 the Mississippi River was first spanned. Mr. Corbin's activities were extended with the railroads. His old books, preserved by his son, Austin Corbin, of New York, show that he made farm loans for eastern investors at Davenport in 1855, and in Adair County, Iowa, in 1858. In 1860 he sold farm mortgages from Mississippi. He continued to take farm mortgages from the West after his return to New York in 1865, and placed loans on farm lands near Wichita, Kansas, in the seventies after the railroad reached that city. In view of the early impetus that he gave to it, Mr. Corbin may be called the father of the western farm-loan business.

In 1865 Daniel K. Pearson established at Chicago the firm now named the Pearson-Taft Land Credit Company, which claims by this succession to be the oldest existing concern exclusively engaged in lending money upon farm lands. The fine record of this and a few other companies from pioneer days furnishes a striking example of the profit to lender and benefit to borrower in the American farm-loan business, when properly managed. Mr. Pearson, a benevolent but very practical man, undertook in 1867 the funding for individual farmers of their expiring contracts with the Illinois Central Railroad. He saved his Illinois clients their

homesteads, and later did the same service for Minnesota pioneer farmers in their time of need. He encouraged the use of tile drainage in Illinois in 1878, and advanced to many a farmer the necessary money to improve a farm about to be abandoned because of wet soil.

In the seventies, western farm mortgaging became a specialized business. The men and companies that entered it were too numerous to mention. They rapidly pushed the business beyond Illinois, throughout Missouri, Wisconsin, and Iowa, and over the frontier wherever pioneers had settled. Among the most enterprising of the mortgage houses was Burnham, McKinley & Company, a firm composed of A. C. Burnham, J. B. McKinley, and Col. L. W. Tulleys, three lawyers of Champaign, Illinois, who had been handling loans for clients for a number of years. Mr. McKinley was a cousin of President McKinley and uncle of William B. McKinley, the traction magnate. More money was offered than could be invested in Illinois, and the firm opened an office at Ottumwa, Iowa, in 1874, and moved to Council Bluffs, Iowa, in 1875. From this point it ventured across the Missouri. Its loans were made in Iowa at 10 per cent. interest and 10 per cent. cash commission, and in Nebraska at 12 per cent. interest and 10 per cent. cash commission. Colonel Tulleys relates that "funds poured in upon us," and "quite a deal came from England."

These were the prevailing rates for loans in pioneer days, and they had been easily paid by the early farmers on the lands watered by the Ohio. No one thought that conditions would be any different on the boundless prairies that were now to be opened up. All were confident and oblivious of the future. Thousands upon thousands of pioneers needed money for their homesteads and were willing to pay the top price for the use of it for three or four years. The onrush of immigrants increased the demand, and the possibilities of the farm-loan business at last appealed to men of prominence in financial circles.

Foremost among these was Henry Villard, the highly educated and talented German-American, who migrated to Belleville, Illinois, in 1853, studied law, drifted into journalism, became a famous war correspondent, and finally made and lost a fortune in railroading. Mr. Villard's control of the Oregon & California and the Northern Pacific railroads and his receivership of the Kansas & Pacific gave him wide knowledge of the West. He was familiar with the methods of financing farmers in his native country, and strove to introduce them in the United States. In 1869 he wrote an article on coöperative banking for the American Social Science Association, of which he was secretary. From 1870 to 1874 he sojourned in Europe, and while there he made a study of long-term mortgaging and interested the *Bankverein*, one of the large Berlin banks, in a project for forming an American company for this purpose.

The circulars which Mr. Villard published in furtherance of his project referred to the proposed company as the "Crédit Foncier" * and "Mortgage Bank," and described its object as investment "in mortgages in the Western States." His correspondence (which his son, the editor of the New York *Evening Post*, has permitted us to read) shows that he had long-term mortgaging in mind. He interested the following men: William Endicott, Jr., James B. Thayer, J. M. S. Williams, J. Warren Merrill, Albert Crosby, Henry S. Russell, Edward Atkinson, Peleg W. Chandler, Corydon Beckwith, Charles H. Dalton, Abner I. Benyon, Rudolph Schleiden, Seth Turner, George B. Clapp, David R. Greene, John J. McKinnon, Austin Sumner, Sam. H. W. Walley, William Claflin, and

* *Crédit Foncier* is the French term for land credit.

Thomas M. Devens. Most of them were influential citizens of Boston, and their identification with Mr. Villard's project attracted much attention.

In April, 1872, these associates had a bill introduced in the Massachusetts Senate to create the Massachusetts Mortgage Company. The bill was passed and approved on May 6, 1873, but for the creation of the Boston Mortgage Company. The act was private and special and objectionable in other respects, owing perhaps to the fact that Mr. Villard was abroad at the time of its passage. The company was dissolved in 1892. About the same time a similar bill was introduced in the Illinois Legislature, as appears from the following excerpt from a letter, dated January 24, 1872, to Mr. Villard from Horace White, then editor of the Chicago *Tribune:* "I send you by this mail a copy of Greenbaum's Crédit Foncier bill, which has not yet passed, but I think will."

The great fires of 1871 in Chicago and 1872 in Boston halted progress on these two projects, but the opportunities which Mr. Villard saw attracted a group of men in New York, and a long-term mortgaging company was chartered in that state in 1871 and actually began to do business. This was the United States Mortgage Company. Its incorporators were J. Pierpont Morgan, Walter H. Burns, Abiel A. Low, Henry S. Fearing, Charles G. Landon, Charles Tracy, Benjamin F. Hutton, David Hoadley, John J. Cisco, David Dow, Charles H. Marshall, Henry A. Hurlbut, John Steward, Francis Skiddy, John A. Steward, Thomas C. T. Buckley, and John Auchincloss. Its charter provided that it might make loans "for any period of credit, repayable by annuity or otherwise." This company was heralded as the model of the *Crédit Foncier de France,* but it gradually ceased to lend on farm lands. Defects in the real-estate laws presented risks which the managers did not care to assume. The concern still exists, but as a trust company, to which it was changed in 1891. Thus the idea of long-term mortgaging for farmers was abandoned shortly after it was conceived, and, in spite of the strong men back of it, left not the faintest impression.

A decade before the withdrawal of the United States Mortgage Company from the field the work of covering the South and West with three- and five-year high-interest mortgages had begun in earnest. In 1882 James L. Lombard, with his cousin, Benjamin (mentioned above), formed at Creston, Iowa, the Lombard Investment Company of Kansas. This was an offshoot of the Bank of Creston which the Lombards had formed in 1872, and it took over from the bank the real-estate loan business which Benjamin Lombard had slowly built up since 1854. James L. Lombard was more daring than his cousin, and in 1885 he removed the headquarters of the company to Kansas City, Missouri, where he formed the Lombard Investment Company of Missouri and five subsidiary companies. Through these, in the heyday of his glory, he was making loans and financing ventures in eighteen states and selling securities throughout the United States and in several European countries.

Mr. Lombard's energy and persuasive talent made him peculiarly able as a boomer of a new country, and he set a pace that boosted the loan business so high that it eventually disappeared in the blue skies over the western frontier of Kansas. An expanse of desert and the Rocky Mountains prevented it from reaching California, but it cast its shadow over Texas and to the northward over Oregon and Washington. Mr. Lombard's marvelous success in getting money made the thing look so easy that farm financing and town booming quickly became a popular method of exploiting investors. The laws themselves were a temptation, because generally they required neither paid-in capital stock, reserves, nor supervision, and the field was overrun by as bad a lot of financial freebooters as ever preyed upon the public.

Companies chartered in almost all the southern and western states were thrown into abnormal competition with one another in both lending money and selling securities, and the craze began. Bank clerks, preachers, and confidential employees who had acquaintance or influence with depositors of savings and custodians of trust funds were enlisted or inveigled into service. Farmers were made agents and induced by the splitting of heavy commissions to spread glowing stories about the wonders of the far-away, single-crop farming. The pressure of money for investment was as strong as the demands of landowners for funds, and the East was flooded with mortgages, guaranteed and unguaranteed, and with bonds and debentures, called in their latter ignominy "jaybirds," because of their similarity in color, tone and character to the gaudy, raucous and rapacious Kansas songster.

Farms which could not be sold at any price were easily mortgaged for more than they were worth; and it was in this way that discouraged mortgagors often raised the money to take them to homesteads in the immense tracts of cheap government land, which during that period lay open as a refuge for disconsolate borrowers who had abandoned their old homes to escape interest and other charges. Perhaps a majority of the defaulted mortgages were foreclosed without contest. Public advertisement never discovered the defendant; he was afraid of the deficiency judgment that was entered after the water had been squeezed out of the highly speculative values upon which he had obtained his loan. Some of the larger companies had subsidiary companies to take over land sold under judicial sale and to pay for it by making new mortgages of their own. Not infrequently they platted the vacant land, issued "jaybirds" against blanket mortgages on townsites, pocketed the proceeds, and left the paper cities to be built by the oncoming generation.

At the height of the craze there were 167 licensed companies selling southern and western securities along the Atlantic seaboard. These were by no means all. There were many other companies operating in states where licenses were not required, besides scores of individual brokers and agents. Thirty-nine companies had nearly 800 agents in New York State alone. In Massachusetts the sales of the securities for years amounted to ten to twelve millions of dollars annually. These securities, as then generally understood, were liens on farm or city property in that part of the West beginning at the Mississippi River and ending at the ninety-eighth or ninety-ninth meridian, but extended to North Dakota, South Dakota, Montana, and Washington in 1889, and to Idaho and Wyoming in 1890, when those states were admitted to the Union. The southern territory embraced Texas, Alabama, Georgia, and Tennessee.

Laws for regulating the business did not exist. At length, however, Connecticut became worried, and in 1887 passed an act creating the office of commissioner of foreign mortgage companies and requiring licenses of such companies. Vermont, Massachusetts, and New York passed similar acts within the next three years, and the number of the companies dropped to 123. Most of the failed companies were in Kansas. The Massachusetts commissioner reported the first failure as that of the Showalter Mortgage Company of Wellington, Kansas, which went into the hands of a receiver on November 28, 1890. The trouble spread from Kansas, and on January 20, 1892, the Anglo-American Mortgage and Trust Company of Council Bluffs, Iowa, the successor of the firm of Burnham, Tulleys & Company, was placed in the hands of a receiver. Numerous complaints by investors in other companies swamped the com-

missioners' offices in New England. The newspapers took up the matter and forced investigations. The conditions disclosed were worse than anticipated. The Massachusetts commissioner, in his 1894 report, said, with regard to four of the failed companies:

> The stocks and bonds carried by them were almost of every description—of national and savings banks, railroads, land irrigation, coal-mining companies, etc., some good, some bad, some very bad, and were largely of corporations in which officials of the company had personal interest so that nearly all capital was invested in enterprises of a speculative nature, and the credit obtained by the company as a mortgage company was used by them in carrying on "development" schemes.

In another report he said:

> It is a noteworthy fact that the sound companies still in existence are those which confined themselves most exclusively to loans on farms.

On February 10, 1893, the Massachusetts commissioner notified the Attorney-General that the Lombard Investment Company of Missouri was "transacting a business and its condition is such as to render its further proceeding hazardous to the public." On September 21, 1893, this company and its subsidiaries were placed in the hands of receivers, with outstanding liabilities around $40,400,000. On September 28, the Jarvis-Conklin Mortgage Trust Company was placed in the hands of receivers; a large part of its funds was tied up in irrigation projects. Similar steps had also been taken against the Equitable Mortgage Company on August 30; a large part of its funds was tied up in bank stocks. These three companies were located in Kansas City, Missouri; they were the largest in the field, and their failure not only destroyed public confidence in the West, but spread consternation throughout the country and ruined most of the smaller companies, both good and bad, or else caused them to suspend operations. The crash had come, bringing disgrace to some and untold misery to all involved in it. Contrary to a general belief, however, the "money kings" had not interested themselves in the business, although a few wealthy men, to their lasting regret, bought shares because they were sold cheap and the prospects for dividends looked good. The great majority of investors were widows, orphans, school teachers, eastern farmers, churches, and eleemosynary institutions, and the losses reduced many to poverty and want. The effect was distressing. The memory of that miserable period still exists and is the reason why such extreme caution is now displayed in investing in farm mortgages.

The money came mainly from New England, central New York, eastern Pennsylvania, New Jersey, and Delaware. It has been calculated that upwards of eight hundred million dollars of securities were sold, but the records are fragmentary. The 113 licensed foreign companies and the ten domestic companies reporting to the Connecticut commissioner between 1887 and 1894 had an aggregate capital stock of $39,018,434. The loan operations of 43 were not mentioned; but assuming that their assets of $29,915,870 were invested in loans, the total amount of loans of the 123 companies was $366,685,579. Twenty-six of the companies claimed that they did not issue bonds or debentures. Twenty-six others did not report on this point. Seventy-one reported bonds or debentures in circulation to the amount of $75,237,370.

It must not be understood that the losses equaled the outstanding liabilities. There were equities in all cases, and the return of good times and rise of values in the South and West made the larger proportion of the securities worth the debt. Investors who held on generally recovered their claims that were secured by farm mortgages. The greatest sufferers were those who sold out from panic or necessity. Not a few men who were familiar with the situation and confident of the future enriched themselves by buying defaulted bonds and mortgages at a discount after the panic. A handful of the companies weathered the storm,

and these are now strong and prosperous. Although plenty of wrongdoing was alleged, the disaster which overwhelmed the companies was due mainly to overconfidence, bad judgment, faulty methods, and the lack of regulatory laws. There would have been no crash if the mortgages had been long-term, and the issuing of the bonds and guaranties had been properly supervised, because within 20 years after the crash the value of the farm and city properties taken in security had risen far above the amount of the loans by which they were encumbered. The companies, investors, and farmers paid a frightful penalty for the violation of correct principles in this first attempt to organize land credit in the United States. But after all that may be said against it, the attempt did more good than harm, because it was the greatest factor in financing farmers in the West during the pioneer days and in the South during the reconstruction period.

Only fifteen of the companies renewed their licenses to do business in the East in 1894. The calamity in the West reacted on the South, and soon no company was left in active business. The craze had lasted about seven years. It began in 1886, with the industrial expansion that followed the hard times of the four preceding years, and was at its height just before the crash in 1893. But there were early premonitions of the troubles to come. Defaults were frequent and heavy from the start. Foreclosure lawyers were drumming the Atlantic seaboard for clients at the very time that the companies' agents were trying to sell securities in the same places. This hand-in-hand relation between the representatives of the two ends of the business created distrust. Investors not only refused to make new loans, but demanded immediate payment of claims when due. The market naturally tightened, and the only way by which brokers and agents could raise the money necessary to finance the farmers was by offering stocks and bonds below par and interest at exorbitant rates.

Indeed, there was widespread discontent among farmers as early as 1887. This was unintentionally fanned into a fury by Bronson C. Keeler, of St. Louis, who for many years had devoted much thought to economic and social questions. He wanted to know how many farms and homes were owned by occupants and what proportion of them was encumbered with debt. His resolution demanding an investigation through the Census Bureau was adopted by the Single Tax League at St. Louis in 1889. A copy was sent to every labor, religious, and agricultural newspaper, and to the weekly editions of the daily press. The Chicago Board of Trade, St. Louis Merchants' Exchange, Little Rock Board of Trade, Patrons of Husbandry, Farmers' Alliance, Industrial Union, Knights of Labor, religious bodies, agricultural fairs, and labor organizations joined in the request. Shortly before Congress convened, Mr. Keeler made his master stroke through an address published as a "patent inside" by newspapers whose circulation in rural regions exceeded 5,000,000 copies a week.

On December 10, 1889, Senator James H. Berry introduced Mr. Keeler's resolution in the Senate upon petition of the Agricultural Wheel of Liberty, Benton County, Arkansas. The debate was short and unilluminating. On February 24, 1890, President Harrison approved the act which required the Eleventh Census to cover the indebtedness, title, and tenancy of real estate. The appropriation for the purpose was $1,000,000. The census stopped with the year 1889, so the investigation embraced only the early part of the craze. It was not finished nor were the results published until September 25, 1894, or after the crash had occurred; so it was of no practical use as far as the mortgage business was concerned. But the inquiries made by government officials, through

the mail or in personal interview, of the 9,517,747 mortgagors of farms and homes found to exist during the decade investigated increased the distrust and demands for reform.

Aside from Mr. Villard, almost the only person who appears to have had the right idea as to the course to pursue in this disastrous first attempt to finance farmers in the United States on a large scale was Edward T. Peters, then in the statistician's office of the United States Department of Agriculture. Mr. Peters was interested in the personal-credit branch of the subject. He submitted articles to the Department on coöperative societies and syndicates, which he recommended to the consideration of American farmers. Finally he was detailed to carry out an investigation along this line, and in 1892 was published his pamphlet on "Coöperative Credit Associations in Certain European Countries," describing and explaining the systems of Schulze-Delitzsch and Raiffeisen. The effect of this valuable little book, however, was nugatory; all it did was to excite some discussion in literary journals. The seed that Mr. Peters sowed fell upon barren ground. If it had taken root and flourished during the last twenty-four years, and if Mr. Villard's plan of forty-four years ago had materialized, no one would be asking today for government aid for farmers.

Aside from the public and semi-public establishments, there are only four kinds of land-credit institutions: (1) companies for insuring or guaranteeing titles or mortgages; (2) building and loan associations; (3) landschafts; and (4) bond and mortgage companies or land-credit banks. The first have reached nearer to perfection in the United States than in any other country, so they need not be discussed. The pages that follow will be devoted to the three remaining kinds, and to coöperative banking and to its use in agricultural organization.

CHAPTER III

BUILDING AND LOAN ASSOCIATIONS

A building-and-loan association is a corporation with a variable capital stock; that is, a capital stock which may be increased or decreased by the issuing or the canceling of shares, or by payments or withdrawals of payments on such shares. According to the original design, its sole powers are to receive members' savings to lend to members for building or acquiring homes. The encouragement of thrift and of the owning of homes is its sole and characterizing feature. This purpose is considered benevolent under the law, and for this reason building and loan associations enjoy tax exemptions.

The administration of these associations is composed entirely of members and is subject to the supervision of the state banking department. The district of each is delimited by a radius of a few miles from headquarters, so as to make all operations local. Most of the associations are small and composed of persons poorly or moderately circumstanced; the smaller the better, because invariably coöperative spirit and methods are weakened with increase of size. When the membership becomes so numerous that all the members do not attend the meetings regularly, the danger point is reached, and then it is much to be preferred that some members retire and form a new association in the same neighborhood. Coöperation can come only through decentralization and community life. Each unit should be self-sustaining and so small that members, one and

all, may keep careful and constant watch over its affairs. Only in this way can persons not trained in finance or schooled in the true principles of coöperation, as is usually the case with the members of building and loan associations, assure themselves absolutely of the safety of their association and maintain its proper character.

The savings of members are obtained through the issue and sale of shares. Shares are of various kinds. The most common are instalment shares, on which the subscriber makes payments at stated intervals, and investment shares, on which the subscriber may make one payment in full or partial payments at periods usually arranged to suit his convenience. An association called "permanent" may issue shares at any time; one called "serial" may issue its shares only in series. No new shares may be issued in a series after a dividend has been declared, except to subscribers who pay the book value of such shares.

Instalment shares are the ones in general use for loan transactions. A borrower is required to subscribe for instalment shares in an amount equal to his loan. A first mortgage must be given on the property for which the loan is made and the shares pledged to the association as an additional security. Non-borrowing members may subscribe for as few or as many shares of any kind as they please. Payments made by members serve to mature their shares. Each share is credited also with its proper portion of the profits. At maturity the shares are canceled. If a member is not indebted to the association, he is given the face value of his shares in cash. If he is a borrower, this value offsets his debt and his loan and mortgage are canceled with his pledged shares. Pledged shares may not be withdrawn until the loan has been fully paid, but the credits on "free" shares ordinarily may be withdrawn upon 60 days' notice.

The instalment share was originally the only kind issued. Its subscription creates an obligation to continue the periodical payments until maturity. It is a form of self-imposed compulsory saving which inculcates habits of thrift, frugality, and economy in both investor and borrowing member, and best brings into play the true object of a building and loan association. But whatever the kind, shares are the only credit instruments of the association. Inasmuch as it is entirely financed in this way, loans cannot be made, of course, any faster than savings accumulate; some members must go without loans. This difficulty is inherent in the coöperative method of finance employed and cannot be removed without vitiating the very essence of a building and loan association. The difficulty is fairly well met, however, by giving all members an equal chance by auctioning off the loans, and by increasing cash dividends for investor members by charging premiums on the loans. There are at least 68 premium plans, 25 plans for distributing profits, twelve withdrawal plans, and seven kinds of shares.

The auctioning of the available funds on hand to the highest bidder at a regular or special meeting of the association is the usual method of awarding loans. The sum which the borrower pays in addition to the interest is called the premium. The rate of interest, therefore, may be higher than the maximum set by the general laws on usury. This, with tax exemptions, is the association's only special privilege. Entrance fees and fines for withdrawals and defaults may be imposed also. These are the sources of its profits. The average annual rate of dividend is larger than that on deposits in any other kind of savings institution, yet the interest and other charges on loans are not excessive, owing to the fact that little is spent in salaries and expenses.

The loan and its pledged shares must correspond in maturity as well

as in amount, and the former be paid off as the latter are paid up. Consequently, the loan is reducible usually by annual or semi-annual instalments, exactly as the shares are paid, and may run for a term of as much as ten years or more; but no building and loan association in America practices true amortization of loans by annuities. Indeed, long-term lending is not advisable except within conservative limits, because the association operates with savings subject to call on short notice. Hence, it should invest its assets in such a way that they may be cashed to meet reasonable demands for withdrawals and turned over rapidly enough to pay attractive dividends. This would be difficult if all the assets were invested in loans running for many years. True, considerable long-term mortgaging is done, but it is possible only because liabilities are reduced by the pledging of shares for the loans, and because the associations are purely coöperative and members realize that they would be injuring their own interests if they should make a run on them during hard times.

In its pure form, a building and loan association cannot incur any expenses above a small percentage of its annual income; nor can it borrow for any purpose, issue bonds or contract obligations of any sort with outside parties. The power granted in some states to borrow to relieve an emergency is theoretically wrong, even though the sum so borrowed be insignificant. The association is designed for utilizing not the credit, but the cash of members, for affording them a safe and profitable investment for earnings actually saved, and for the use of these savings in mutual self-help for home building. This certainty of profit and chance to get a loan both encourage thrift; but the lending is subordinate to the saving feature, and necessarily so, because an attraction must first be created for money before it can be obtained.

A building and loan association is distinctively a thrift society, whether considered from the standpoint of the investor or of the borrower. The compulsory periodical saving and the obligatory investment of funds among members give it such a character to a greater extent than is possessed by a mutual savings bank or any other kind of thrift institution. For this reason the law has simplified its operations and management to meet the most ordinary degree of intelligence and care, and has surrounded it with such safeguards that it cannot waste, speculate with or misapply its funds. It may invest them only in first-mortgage loans to home builders or place them in securities of a kind designated by statute if not so invested. The greatest of its safeguards is that it cannot use its credit in any way to become indebted to the outside world. Its only possible liability is the dues owing on shares. Its only creditors are its own members, and since they are the owners of and the sole claimants against its assets and are bound by the by-laws to which they all agreed at joining, it is not likely ever to be pressed heavily by them. With such an arrangement safety is automatic, while methods are perfectly coöperative, since the association is not only used and managed, but also financed exclusively by members.

The building and loan idea is the only successful application of pure coöperation to land credit, but in the United States and elsewhere every association is urban. Experience has proved that the idea is practically useless for agriculture. The reason for this is that the associations can carry on their twofold function only in places where investment seekers are more numerous than loan applicants. An association must have for easy and orderly operation a preponderance of investor members—members of whom the majority join to save and not to borrow, and from whom a steady flow of periodical payments can be obtained. Such persons are found in the necessary numbers only in towns and cities and among clerks and workmen accustomed to receive salaries and wages weekly or monthly and to pay rent at the same intervals. In the country the population is too sparse; moreover, agriculture does not create separate classes, composed exclusively of either employers or employees, as much as do city-centered industries.

Agriculture tends to make of every worker his own master and to give him a property and business in which, if he be capable and active, he can use not only all his own, but borrowed money besides. This inspires the tenant, and even the hired hand, to utilize his available cash and credit for acquiring a farm of his own. Hence, the borrowing element predominates over the investor element in all agricultural regions, and even where wages and salaries are abundant, few of the recipients have any money to place at interest or to lend to others, a fact which cannot be changed through coöperation. Consequently, the building and loan association is not suited to agriculture except as farmers may now and then be admitted to membership. Such an association, if located in a rural district, would become overcrowded with applicants for loans, and if it should attempt to extend credit upon the long and easy terms that agriculture requires, it would so reduce profits as to drive out investor members and cause it eventually to disband.

In the United States, in 1914, there were 6,429 building and loan associations, with 2,836,433 members and $1,248,479,139 of share capital. These figures mean one member for every 13.45 persons engaged in gainful occupations, or one member for every 7.14 census families, or one member for every 2.55 urban dwellings; and one dollar of assets for every $13.91 of individual deposits in all the banks. This is the greatest, and in some respects the most wonderful system of coöperative finance in the world; it has had a steady but slow growth, beginning in 1831, and has been built up through private enterprise and mutual self-help without aid or thought of aid from government. But this great system cannot boast of an unbroken record of success. At several periods the American building and loan associations suffered very seriously from the consequences of deviating from true principles. In the seventies, and again in the nineties, there were many failures in some states, which may all be attributed to the fact that the laws did not require adequate supervision, and big associations were formed by persons who had no regard or exact knowledge of what coöperation really is. Then came a cleavage between the "national" or large, and the "local" or small, associations. As the New York Superintendent of Banks, in 1914, reported:

> For many years there has been a distinction . . . not recognized by statute, but resulting from difference in their methods. The so-called local associations were really coöperative. The national associations, as a class, entirely lost sight of the principle of mutuality, were conducted more in the interests of their officers and promoters than in the interest of their members, and attempted to do business over a widely extended territory. As a result of mismanagement, or worse, most of them went out of existence many years ago.

During the last decade laws and methods have again been undergoing a pernicious change, and there are many instances where coöperation has ceased to be practiced. The extent of the deterioration, however, is not known, since the only comprehensive investigation ever made of the American building and loan association is the report submitted by Carroll D. Wright, United States Commissioner of Labor, to President Cleveland on May 1, 1894, over 21 years ago. But the available information is sufficient to show that in a number of states the building and loan association no longer exists in its original purity, and that laws and methods are badly in need of revision and reform.

Like every other kind of institution, the building and loan association

is designed for a particular purpose, and can be safe and successful only through strict adherence to its aim. There are natural limitations to its powers and usefulness, any transgression of which leads to danger. The most dangerous departure from correct principles is the right accorded in some states to use the credit as well as the cash of members and issue bonds or other debt obligations. This alarming innovation not only imperils the safety and soundness of the associations, but also completely denatures them, organized as they are only for receiving and investing members' savings. To allow them to use the credit of members is as wrong as it would be to authorize them to make loans to outsiders; it is indeed far more detrimental than such a practice, because it puts the money of the investing public in competition with the savings of members and thus lowers dividends, encumbers the association with liabilities to outside parties, deprives members of their first lien on its assets, and involves the association in an intricate and risky method of finance, to which its average officer has neither the necessary experience nor time to give the proper attention.

The bond-issuing right utterly destroys simplicity in operation and abolishes the most important safeguards. If exercised extensively, it would finally defeat itself by driving out investor members and stopping up the easiest source of funds, which is savings; then the denatured association, reduced to the necessity of continual borrowing and compelled to trustee its assets for bonds, would have no security or attraction to offer to members. The credits on their shares would be tied up with the trusteed assets and could not be withdrawn at will; the larger portion of the earnings would be turned over to outsiders in interest to bondholders; while borrowing members could be shown no leniency since their defaults would impair the ability of the association to meet the claims of its creditors. Under proper laws and methods, a building and loan association cannot be sued even by members; the supervising authority takes possession of and administers its affairs if it fails to meet its obligations. If it is allowed to issue bonds, the dangerous possibility of litigation with outside parties is always present and its coöperative character disappears along with its safeguards. It ceases to be automatically safe, and only a very foolish person would intrust his savings with it.

The American building and loan associations have been imperiled by the dangerous and denaturing innovations proposed by Senator Hollis and other leaders in Congress and by the vitiating laws enacted in New York and Indiana, which violate basic coöperative principles by substituting government intervention for self-help and private enterprise, and by authorizing bond issues in place of collective savings as a means of finance. Massachusetts and Kansas also have perpetrated legislative wrongs in this recent attempt at the impossible achievement of adapting building and loan association, to farmers and through it utilizing their credit, savings, and deposits in long-term operations.

The Hollis-Bulkley bill provides that an association, when composed of farmers and organized under a Federal charter, shall have an appraisal committee of which one member shall be a semi-official outside person; also, that it may receive deposits without limit from anybody, and use its funds in mortgage loans not only to members, but also, through purchase from other associations, to non-members. The bill further provides that such mortgages shall be "instrumentalities of the Government of the United States," and that the association may pledge the same as security for bonds and incur thereby obligations to outside parties up to 20 times the amount of its capital and surplus, in addition to the

liability for deposits accepted. The bonds shall be issued by land-credit banks in part owned, financed and managed by the United States Government.

The Fletcher-Moss (or United States Commission) bill provides that its national farmland banks may "apply coöperative principles in the formation and management" of farmers' associations. Nevertheless, it authorizes such associations to issue bonds in representation of mortgage, and allows a maximum circulation of 15 times the capital and surplus of each association. A fiduciary, appointed by a Federal officer, shall countersign the bonds and hold the mortgages used as collateral. This, with certain other privileges accorded, interferes with the practice of coöperation and self-help and spells government intervention. Many of the other bills in Congress are equally as bad as these pernicious measures.

New York has effected the same innovation by the creation of one monopolistic institution called the "Land Bank of the State of New York," erected out of and over the savings (building) and loan associations. The New York law, as it stood before 1914, was almost perfect. Expenses of the associations were limited to 2½ per cent. of the dues actually received from and credited to members during the year. The borrowing limit was $2,000 if the accumulated capital of an association did not exceed $10,000, or 20 per cent. of such capital if it was over that amount. Sums borrowed by an association could not run for longer than one year nor bear interest at a rate higher than six per cent. per annum. The funds of an association could be invested only in first-mortgage loans to members on improved real estate, suitable for residence or business purposes and situated within 50 miles of headquarters. But radical and ruinously denaturing changes have been made in the law.

In 1914, in order to make way for the Land Bank, the associations were empowered to grant loans for any agricultural purpose; and this might include "fences of a substantial character, artificial water-supply systems, drains, and private roads," thus changing the original object of lending and permitting the associations to undertake the riskiest kinds of land-reclamation projects. They were empowered also to subscribe as much as ten per cent. of their resources to double-liability shares of the Land Bank, and to invest all other funds not used in loans in the bonds of that institution. Furthermore, they were empowered to guarantee the bonds in an amount equal to 20 times the capital invested in the shares, and to pledge their assets for such guaranty; and no maximum was prescribed for the interest rate or for the period of the obligation thus contracted. The law intends that it shall run for a long term.

This novel New York land bank was authorized to be chartered when ten associations with aggregate resources of not less than $5,000,000 had subscribed the $100,000 minimum of its capital stock. Having been so chartered, no other such institution may be formed; its by-laws, adopted by the incorporators, cannot be changed by the shareholders, except by resolution of the board of directors approved by the Superintendent of Banks. Hence, the land bank is not coöperative in organization or administration; nor is it coöperative in operation, because it may make loans to non-members and finance itself by money obtained in the open market. For this reason the New York Land Bank is not even a savings institution; nevertheless, the bank, its capital, funds, and bonds, are exempt from taxation, while it possesses the right of a preferred creditor for all moneys it may deposit in other financial institutions, and has been placed in connection with government by a clause which requires the State Comptroller to serve as its trustee. Its bonds may be issued only on

security of mortgages assigned to it by adhering associations, and such mortgages must be trusteed with that official. The proceeds of the bonds may be invested in 40-year loans, but since the trusteed mortgages might represent members' savings subject to withdrawal on 60-days' notice, a practical difficulty presents itself.

Only savings and loan associations may be shareholders of the New York Land Bank. The sole object of joining is to obtain money through bonds issued in their behalf; but if an association avails itself of this facility, it must pay in interest to bondholders what otherwise would be distributed as dividends among members, and surrender to the bondholders the first lien which members now hold on the mortgages. The only compensation for this is participation in the profits of the land bank, a very inadequate consideration for assuming liability for an institution which may make loans in New Jersey as well as in New York and to persons not belonging to any association. The Bank is located by the act in New York City, where it has opened headquarters in the financial district. Its high privileges, monopolistic right, and extensive powers are sources of weakness rather than of strength, since the greatest care will have to be exercised continually to protect it from designing men attracted by its opportunities. This possibility is all the more real because the Bank is utterly unable to do anything for the savings and loan associations without subjecting them to outside liabilities and denaturing them. It is not conceivable that they will tolerate permanently this centralizing structure which has been erected out of and over them. Eventually the advocates of local associations and the true believers in coöperation will demand that it be cast off. The sooner this is done the better it will be, for its adherents are certainly less coöperative than the associations which refuse to join it.

In Indiana the rural loan and savings associations, authorized by the amendment of the building and loan association law in 1913, may issue bonds and also non-voting shares. Nothing could be less coöperative. The Auditor of the state must appoint some person, not a shareholder, as inspector. Upon deposit with the Auditor of first mortgages on real estate appraised and approved by the inspector, an association may issue bonds up to an amount equal to one-half the value thereof. The Auditor must subscribe his ungrammatical certificate on the bonds, "That there is [sic] held by the Auditor of State of Indiana, as trustee in trust, to secure the payment hereof the securities required by law." The proceeds of the sale of bonds may be used only in making loans on farm lands.

The Massachusetts laws were amended in 1914 to permit the so-called "credit unions" to make 40-year loans for certain agricultural purposes. Until then the only source of funds was members' savings, but now a "union" may, with the approval of the Bank Commissioner, issue and keep in circulation bonds in an amount equal to 80 per cent. of the outstanding loans on real estate and pledge invested savings as a security for the bonds.

In Kansas an amendment to the laws adopted in 1915 authorizes building and loan associations to issue rural-credit shares exempt from taxes and free of fees, premiums, fines, and penalties that may be imposed on other kinds of shares. The payments on rural-credit shares shall be invested in "first-mortgage rural-credit loans on farms" in the county in which the association is located. Verbiage like that leaves no doubt as to intention. It certainly is agricultural, but it destroys the equality that should reign in a coöperative association. The loans may run for 20 years, and must be reducible by semi-annual instalments. The rate of interest

shall not exceed by more than 1½ per cent. the rate of dividends on such shares.

These laws, and the bills proposing bond issues for savings or building and loan associations, are deeply to be regretted. Too much stress cannot be laid on the fact that they are not only dangerous but completely denaturing. The savings and the dues of members should remain the sole source of funds. If other sources be opened, the lowering of dividends that would result from competition between members' savings and outside money would discourage thrift—to encourage which is the chief object of the associations. The tendency would be to drive out investor members and attract only borrowers. This would lead inevitably to seeking funds from the outside instead of depending upon members' savings. Being wrong in principle, it must eventually be bad in practice, especially because, by permitting the associations to become indebted to the outside world, it abolishes the old-established safeguard that made them automatically safe and sound. Only by being prevented by law from incurring heavy expenses and obligations or from undertaking speculative ventures can the building and loan associations operate with safety and remain true to type.

The apology for this unfortunate legislation is that it calls collective credit into play and so in theory does not violate coöperative principles. This argument would be tenable if the funds were assembled for a collective use, as in a Raiffeisen society; or if all members were borrowers or expected to become so, as in a landschaft; or if the motives were altruism and brotherly love, as in a communistic settlement. The practice might be condoned if the legislation had existed from the beginning. But none of these qualifications exists. The stupendous assets of the American building and loan associations were assembled in a spirit and for a purpose entirely different from those mentioned. The mortgages of an association represent simply invested savings, and, under proper laws, members have first lien upon them. If bonds are issued, this first lien passes over to the bondholders, particularly if the mortgages are trusteed. Then the savings, encumbered with the claims of outsiders and divested of all their security and a part of their profits, are so diverted from their proper uses that the association is left as an empty shell, offering no safety or attraction to investor and yet compelled to exercise rigor against defaulting members, thus losing the last remnant of both its utility and coöperative character.

Savings and deposits, whether invested or not, cannot be safely involved in long-term operations or pledged for bonds. Neither can the credit of owners be used for such purposes. No one would think of allowing a savings bank to immobolize all its deposits in long-term loans or to pyramid on its credit. The innovation ought never to have been proposed for building and loan associations, the average officers of which are unfamiliar with intricate financial methods. Savings institutions should avoid credit transactions as much as possible and make their first consideration the safety of the funds intrusted to their care.

CHAPTER IV

LANDSCHAFTS

Just as a building and loan association is an urban, so a landschaft is distinctively a rural institution. The differences between the two in organization, administration, and operation are basic, striking, and pro-

nounced. A building and loan association serves both investor and borrower members; it finances itself by their savings, avoids the use of its credit, makes its loans in cash, and is purely coöperative. A landschaft, on the other hand, serves only borrowers; it has no need of savings, deposits, or working funds coming from any source, from either members or non-members, since it operates entirely upon credit and makes its loans in debentures, while it is neither an association nor a company; nor is it coöperative, although it imposes mutual liability on members. In spite of these fundamental differences, however, there are points of resemblance; both are thrift institutions and both are protected by a safeguard which prevents them from being encumbered with obligations to outside parties.

True landschafts exist only in Germany. A landschaft is a territorial division established by law of a state and is managed by an administration whose executive officers are appointed by the government upon nomination of resident landowners enrolled as members. The division may be subdivided and resubdivided into lesser areas, each with a local administration subordinated to the one just above it. The powers of the landschaft are to issue debentures and exchange them for annuity contracts secured by mortgages executed by members in its favor on farms within its territory, in consideration of loans made to them. It may maintain a bureau to sell the debentures on behalf of the mortgagors to whom they were issued. Nobody joins the landschaft except applicants for loans, and membership ceases upon repayment of the loan; but liability as a member continues for a statutory period, usually two years, after retirement.

Supervision is lodged in either the agricultural or the banking department of the state. The central administration of a landschaft comprises a president, two vice-presidents, an attorney, a secretary, and a treasurer. The local administrations have a similar organization, except in the lowest subdivisions, where the sole officer is a superintendent. The voting strength of a member is determined by the number and amount of his mortgages. The voting is done in "circles" in the smallest subdivisions, for which counties or townships might form the territorial area in the United States. Members elect the superintendents of the circles and also the delegates to sit in convention for selecting nominees for other offices. Beyond this, members have no voice in the management The administrations select their own attorneys, etc., and attend to all the business. It is, however, difficult to generalize on this point because of the many diversities of procedure that have been adopted. These are described in our book.* Acceptance of office is obligatory upon election. Moreover, members are bound, whenever called upon by the proper officers, to act in various capacities, such as caretakers, cultivators, or managers of mortgaged farms taken over upon default. Compensation may or may not be allowed.

A landschaft has no capital stock, nor does it own or receive money for investment. It does not issue shares, certificates of deposit, or other evidences of indebtedness for money borrowed by it or intrusted to its care; it never borrows in any circumstances. The only funds it has are the sinking fund created by repayments of borrowers and used for redeeming debentures, and a reserve accumulated from entrance fees, fines, or a portion of profits and maintained only at a size sufficient to guard against contingencies. A landschaft has no use for cash from members or outsiders, nor for subsidies, foundations, working or permanent capital, or funds of any sort in making its loans, because the only facility

* *Rural Credits*, 2d ed., Part 1, Chap. V ff. (New York, D. Appleton & Co., 1915).

that it seeks or gives is credit, while it operates through a credit organization of the highest type ever devised—through collective credit substituted for individual credit and based on the bedrock value of farm land and on the material and moral worth of the owners thereof.

Members are jointly and severally liable for the defaults of one another, and their mortgages are massed to secure each and every debenture. No security could be safer or more readily negotiable, and so members of a landschaft obtain loans on better terms than do borrowers from any other lending institution. In spite of its members' mutual liability, however, a landschaft is not coöperative, because the members do not elect its chief officers; this fact divests it of a coöperative character. It is a semi-public institution, standing as an impartial intermediary between investor and borrower, but having neither the financial aid nor guaranty of government nor necessarily any special privileges. Early American investigators mistook the administration for the institution itself and looked upon it as a coöperative association. This mistake, into which many European writers also have fallen, is pardonable, since the administration is of the associational form, consisting of members all of whom are borrowers.

Since loans are made only to members, the rights and obligations of membership rest on both the membership certificate and the loan contract. This contract is not a promissory note signed for the repayment of the loan in lump at a fixed period; it is an agreement to pay an annuity to the landschaft indefinitely as long as membership continues. The annuity consists of the interest at the agreed rate and usually one-half or one-fourth of one per cent. of the principal, both calculated on the full, original amount of the loan, together with a contribution to cost of doing business; this last item may be altered at the will of the landschaft and is invariably arranged so as to return all expenses of a loan within the course of its first ten or fifteen years. In addition to these charges, which are paid in semi-annual instalments, the borrower may be fined for defaults or for infraction or disregard of rules and regulations, while he must faithfully perform his duties as a member under penalty of being expelled and having his loan recalled. A first mortgage on farm land is taken to secure the contract; the amount of the loan must not exceed 60 per cent. of the value of the mortgaged property.

No other maximum is set for the amount, nor is the mortgagor required to be the resident cultivator or to use the proceeds for any specified and sworn to purpose. A landschaft is concerned only with the adequacy of the security, and this it determines through appraisers and officers, who see that the occupant is a good farmer and that the farm is productive and capable of yielding an annual income equal to the dues which the borrower obligates himself to pay. To go farther than that, and require the loan to be used for some particular purpose, would necessitate an attention to detail that the landschaft could not give without complicating its operations and increasing the cost of business. Moreover, such a requirement would be impracticable, because a landschaft does not handle the money for the loan. The only control it exercises is to require the mortgagor to perform his duties as a member and borrower and to keep his farm from depreciating in value or from decreasing in productivity. The landschaft reserves the right to recall the loan at will, but it cannot sell or assign the mortgage or annuity contract; hence, since the borrower must remain a member until his debt is called by the landschaft or is finally extinguished, no third party can interfere with their mutual relations.

After the applicant has been admitted to membership and his contract and mortgage have been duly executed and accepted, the landschaft gives

him its own debentures of the same amount and interest rate as his loan. No money passes; the lending is not a cash transaction, but is simply a "swapping" of papers. The borrower sells the debentures which he obtains by this exchange wherever he can get the best price. The premium or the *disagio* falls to him. Nevertheless, no matter what the discount, the proceeds of the sale are more than he could get on his own unaided credit, because his debt, split by the debentures into convenient parts and rendered highly negotiable by the landschaft's name, becomes a first-class and easily marketable security. The annuities and other receipts are carried to the sinking fund or to the reserve immediately after they are paid by the borrowers. A separate account is kept in the sinking fund for each borrower, and entries are made in it of his payments and defaults and also of his portion of the profit or loss of the landschaft. When the balance in his favor equals the sum he originally borrowed, his loan is considered paid.

This may happen earlier or later than expected, since it is affected by the profit and loss of the landschaft; but until this equivalence is attained, the borrower continues to be indebted to the landschaft and his mortgage remains intact of record. So a loan in a landschaft has of necessity an indeterminate life, but inasmuch as it normally runs for a long period, 35, 50, or 75 years, a few years more or less are not of much importance. According to the laws, the filing of the mortgage converts the annuity contract into a rent charge on the land; moreover, until finally canceled, it is notice to the world that the landschaft has a valid claim on the land for whatever appears on its books against the borrower. This allows the landschaft to make any alteration in the original contract that it deems equitable, without impairing its lien.

A marked similarity appears between the methods of accumulating the sinking fund in a landschaft and the capital of a building and loan association. Both come entirely from members through obligatory periodic payments made with the effect, if not in the spirit, of thrift; but there the similarity ends, for a landschaft is the creditor, while the building and loan association is the debtor, of members in respect to its funds, with the landschaft holding exactly a converse position in respect to the outside world. The capital of a building and loan association is accumulated with a view to investment, and may be used in loans or withdrawn by shareholders to the extent of their credits. Withdrawals from the sinking fund of a landschaft, on the other hand, are not optional with members, because it is accumulated not for investment but for redeeming debentures exchanged for loans. A landschaft, however, may permit a withdrawal after the borrower has paid off a certain portion of his loan; and this is the way it grants extensions. In Prussia, moreover, the King has the power to authorize the withdrawal of all the credits of members; and he has occasionally exercised this power in emergencies.

The similarities and the differences between the two institutions should be kept carefully in mind in order to prevent confusion. The motive of both is benefit to members; but one works with cash and strives to make profit, while the other works with credit and, free of all lucrative object, strives only to obtain loans for members on the easiest possible terms. The shares (the sole instruments through which a building and loan association finances itself) cannot be assigned, and they never reach the outside world; the debentures of a landschaft are intended for the market, and they create an outside liability. Consequently, differing from a building and loan association, a landschaft takes security to enforce the periodic payments of every member. The methods of making loans and of creating a sinking fund are such characterizing features of the landschaft that

they are the chief things to be considered in studying the institution. A loan once made ceases to be a borrowed sum to be repaid in lump within a given time; indeed, the full amount of the principal is never repaid. The loan becomes the consideration given by the landschaft for an annuity contract which obligates the member to compulsory periodic saving, just as is the case in a building and loan association; thrift is an aim of both institutions.

In addition to his obligatory annuities, a borrower may make voluntary payments to the sinking fund. The law requires the acceptance of whatever cash or debentures are tendered; and it is by thus increasing his credit balance that the borrower pays off his loan, in whole or part, sooner or at a more rapid progression than is called for by the terms of his contract. The sinking fund represents the payments made by members and the outstanding amounts of their loans. The aggregate should equal at least the par value, with accrued interest, or the debentures in circulation. If a member defaults, he takes away just so much money available for retiring debentures and liquidating the liabilities of the sinking fund. The landschaft covers the impairment by apportioning the loss among all members and deducting it from the credit balances in their respective accounts, thus interfering with the reduction and extinction of their loans and postponing the day for canceling the mortgages on their farms. Hence, members of a landschaft are not indulgent to one another. Defaults are condoned only in equitable cases; renewals are disfavored, and are never granted except after careful investigation approved by the central administration, or else as a consequence of a moratorium enacted for the benefit of all. Subject to the restricted right of withdrawal mentioned above, a member's credit balance in the sinking fund runs with the land and becomes the property of any purchaser of the mortgaged farm. Likewise, of course, the purchaser takes the property encumbered by the rent charge upon it, but he is not required to join the landschaft or personally to assume the borrower's debt.

Different from other kinds of land-credit institutions, a landschaft does not sell the debentures it issues. It does not keep any on hand even for members. The only way they reach investors is through delivery to borrowers in exchange for mortgages. This fact is not altered if the landschaft maintains a selling bureau, since then it acts simply as agent of the borrowers and may charge them commissions on the sales. Although serially numbered, the debentures are not issued in series, properly so called; they are issued singly as each loan is made. They cannot be issued below par. The reason for this is that no debenture should draw out from the sinking fund any more money, in proportion to its face value, than any other debenture. If this method were not followed, the landschaft would have to issue the debentures in series and maintain a separate sinking fund for each series, thus marring the simplicity of its finances. Moreover, the debentures may not be issued above par. The reasons for this are that the landschaft has no lucrative object and that one borrower should not be required to pay any more for its facilities than any other borrower. In this way the impartiality of the landschaft is preserved not only in its relations between borrowers and bondholders, as classes, but also in its dealing with each individual member and bondholder.

There is no limit to the output of debentures, nor is there necessity for one. The debentures are negotiated only after the loans are made, and none gets in circulation except in representation of a mortgage placed on farm land worth more than its face value and further secured by the collective liability of all the members of the landschaft. Each borrower

brings to his landschaft more credit than debt; the security of every loan is far greater than its amount, and besides is ample to meet any assessment for the default of another that a member might be called upon to pay. So, by the distribution of risks and the law of averages, a landschaft becomes safer and stronger the larger it grows. It may continue to issue debentures for mortgages on farm lands situated within its district as long as members have financial needs to be supplied and can furnish the security required by law and its regulations. The only restriction is that, after issue, debentures must be paid off as loans are paid up, or else be so retired by purchase that all the funds of a landschaft are invested in its own obligations. The limitation which restricts the bonds of a company to 20 times its capital stock and surplus could not, of course, be applied to a landschaft, which has no capital stock and accumulates no earnings; moreover, any arbitrary limitation of the sort would be unnecessary, for the reasons stated.

The usual denominations of debentures are $100 and $20, so as to enable the borrower to sell the debentures to small investors and attract the savings of thrift, which in all countries constitute the greatest hoards of wealth and the easiest source of funds. To each debenture are attached interest coupons for ten years and a "talon" entitling the holder to another set when the preceding one is exhausted. The debenture may be registered or unregistered. The rates of interest they may bear are prescribed by law, and usually are 3, 3½, 4, or 5 per cent. per annum. The supervising authority fixes the minimum and maximum from these statutory rates. The borrower has the option to designate the rate as well as the denominations and kinds of the debentures issued to him; and in this way is determined the interest rate of his loan, which must correspond exactly with that of the debentures in which it is made. But the cost of the credit so extended depends, of course, on the market quotation at the time of the negotiation. The debentures are a legal investment for public and fiduciary funds, and the underlying mortgages usually are exempt from taxation. This provision was adopted to render generally marketable an unquestionably safe security and to do away with double taxation. The tax exemption, however, is not a special privilege, because, it must be borne in mind, the borrower executes his contract and mortgage and receives the debentures for the same debt, and it would not be fair to tax this twice.

The mortgages taken by the landschaft are not trusteed for the debentures. Trusteeing would be unnecessary, because a landschaft's only assets are mortgages and receipts from borrowers, its only business is the finding of credit for members, and its only possible cerditors are the debenture holders. The debentures are secured by the general standing and all the resources of the landschaft. These include the collective liability of members, arising from the fact that members' dues upon receipt are first applied to make good deficiencies in the sinking fund occasioned by default of any borrower. This collective liability may be limited in some statutory way, such as to a percentage or a multiple of the amount of each individual loan or of the value of the land mortgaged for it. But limitations of this nature upset the sinking-fund arrangement and devitalize basic principles; so the true landschafts insist upon unlimited liability, that is, liability extending to personal assessments equal against all members to maintain the sinking fund and reserve at an amount sufficient to meet the principal and interest of the debentures.

The debentures specify that interest shall be paid every six months, but do not contain one word about the payment of principal. Consequently, since they do not attach either as a fixed or even as a floating

charge against the mortgages, they are mere naked acknowledgments of indebtedness of certain amounts, without any date set for redemption. They are a liability against the sinking fund and the members, rather than of the landschaft itself. The obligation of the landschaft does not arise from the wording of the debenture, but results from provisions in the law under which it operates. But these provisions do not oblige the landschaft to pay the principal or even the interest before obtaining it from its members. The law simply requires that every six months debentures shall be redeemed up to the amount of the cash on hand in the sinking fund. The deficiencies in this fund caused by defaults of members are not added to the amount to be paid out, as is usually required by the laws on joint-stock land-credit companies.

The retirement is done by lot. The debentures thus selected become exigible; interest stops running on them after official publication, and they must be redeemed if presented before expiry through the statute of limitations. If not redeemed, the only recourse of the holders is a receivership; individually they cannot sue the landschaft. The drawings, however, are not the only way in which debentures are retired. A landschaft may purchase them like an ordinary investor, while borrowers may pay their dues with them. Thus, both may take advantage of any drop in the market to reduce their liabilities; and since this makes the debentures always worth their face value as an investment for the sinking fund or as a payment on the loans which they represent, it tends to steady quotations. Purchased debentures may be reissued, but those withdrawn by lot must be canceled. The use of debentures as cash for payment of loans is possible in a landschaft, because this associational institution has no lucrative object, and members should have a chance to reap the advantage from any premium since they suffer the loss of any discount. The right, however, would be neither practical nor fair in a joint-stock company, because the capital of a corporation is an investment of shareholders that should be allowed attractive dividends and protected from the risks of business by a reserve and a surplus created out of earnings. A disregard of this distinction has spoiled most of the bills introduced in Congress.

The compulsory semi-annual drawings do not require money to be paid out in advance of its receipt. The debentures do not become a claim against the landschaft until it is ready and willing to pay and has by its own act made them due. Hence, a landschaft, like a building and loan association, is protected by a safeguard that prevents it from becoming overburdened with debt to outside parties. The only obligation is to pay interest every six months and to return the principal after recovery from the borrowers. But this obligation is acknowledged without fear or favor, for the landschaft is not organized for charity. It must protect members from defaults of one another with the same impartiality that it displays between them and the bondholders. If summary proceedings for foreclosure are not provided by law, a landschaft provides for them by clauses in the mortgage which it enforces to the letter, unless there be strong reasons for leniency.

The effect of the periodic drawings is to amortize at once the debt of the borrowers and the corresponding claims of the bondholders, and also to prevent the debentures in circulation from ever exceeding the aggregate amount outstanding on the loans. The mortgages always at least equal the debentures, while the sinking fund, composed of repaid loans and employed only in redeeming or retiring debentures, is reduced to nothing every six months; it cannot be invested in new loans, used as a working fund, or diverted in any way from its proper purpose. Conse-

quently a landschaft cannot pyramid on its credit, become encumbered with debt, accumulate idle funds, speculate, or deviate from its true course as a land-credit institution created and managed for the benefit of members. But it must act as a disinterested intermediary between investor and borrower, because it is a credit dispenser and not a money lender. It collects from the borrowers the loans which it has enabled them to obtain, and forthwith returns these collections to the debenture holders from whom they originally came; and it receives no pay or compensation in the transaction, nor does it strive to make any profit to distribute among others. No stockholder or creditor of any sort stands between it and the lenders and borrowers; no claim, except that of a debenture, can possibly attach to its assets. So the debentures are the sole liability on the mortgages, each representing the actual lending value of a particular farm, and having, by reason of the associational guaranty, the annual income from all the mortgaged farms in the district for its repayment.

With such an arrangement failure is almost an impossibility and has never occurred. Of all the institutions devised for land credit, the landschaft is the only one that preserves this direct and exclusive lien on its entire resources for the instruments through which it utilizes its credit in the market. The landschaft plan is the oldest of all the schemes devised for organizing land credit, and is acknowledged by European authorities to be the best for long-term loans on farm lands. It holds the preëminence in this field that the building and loan association plan holds among urban homeseekers. Most of the landschafts were established by special acts before general laws on incorporation, mortgaging, and registration of land titles were enacted or thought of. These special acts differ from the present general laws and give the appearance of special privilege. This, appearance, however, is true only in part. The main point of difference is in the method of recovering claims; but this is not vital, because any company or association could—and usually every one does—obtain by contract with its customers or members the same right which a landschaft enjoys by law of summary proceedings against delinquents.

Aside from this peculiar right, originating in Frederick the Great's efforts to assist the impoverished landed nobility, the landschafts are not recipients of government favors to any marked degree. They do not enjoy tax exemptions, subsidies, or state aid of any sort, except the intervention of government in the election of their executive officers. The probabilities are that if landschafts were to be established anew, they would not be set apart for special distinction; so it is to be hoped that the use of the cash or credit of government will not be urged at their establishment in the United States. State aid, unless it be a direct guaranty, could not make the debentures sell at a better figure than they bring today; so such aid would be not only useless but worse than useless, because it would destroy the mutuality in responsibility among members—the basic principle of a landschaft and the cause of its success and safety.

The establishment of landschafts in the United States is a matter for the legislatures of the states. In drafting the laws, the framers should bear in mind that a landschaft is a district and not a company, coöperative association, or eleemosynary society. The lawmakers in some European countries were badly bewildered in this particular and brought forth fantastical institutions that are more attractive on paper than in practice. The Swedish, Danish, Muscovite, Italian, and recent German so-called landschafts are examples to be shunned. America should go back to the old Prussian landschafts, eliminate their antiquated bureaucratic

methods and latter-day denaturing excrescences, bring to light the original idea, and apply it in its pristine purity by dividing the agricultural states into districts for issuing debentures for loans secured by massed mortgages on farm lands and guaranteed by the unlimited, collective liability of the borrowers.

This does not mean, of course, that farmers should be forced to become members, or that the liabilities of a landschaft should be legislated as an involuntary lien upon the farms of persons who do not belong to it. The legislation should be permissive only, and simply create the facility and render it available for all who may choose to resort to it for long-term loans. Each district, if there be more than one landschaft in a state, should be separate and distinct, not complicated by subdivisions or combined with any other district. Its boundaries should not embrace, for instance, both swamp or arid and improved and highly productive lands, with a view to striking an average to strengthen low, at the expense of high, values. Its entire area should have the same climatic and other conditions, the same appraising and lending methods, so that the debentures issued on the farms therein shall all bear the same interest rate, as near as may be. This would prevent complaints of discriminations and also practices that might justify such complaints. No special privileges should be accorded, other than to exempt from taxation the mortgages held by a landschaft and to make its debentures a legal investment for public and fiduciary funds.

A landschaft should not be authorized to make short-term loans; such business, involving numerous details and renewals, calls for more time, care and responsibility than members could afford to give to it. The obligatory performance of duties as president, managing officer, or receiver, if the demands were frequent, would interfere seriously with a farmer's own affairs. The sole province of a landschaft is the making of loans that run for many years without need of much more attention than is required to see that annuities are promptly paid. As a result, their business is necessarily restricted, because only a minor proportion of mortgages are ever made for long term, no matter how well land credit may be organized. All farmers do not want them, while the possibility of depreciation in the security that may be offered puts a natural limit to their acceptance.

The shifting of population has a greater effect on real estate than on any other kind of property. Buildings may be insured against destruction but not against vacancy, decay, or changes in use or value. Hence, appraisals for long periods must be based mainly upon the land; so it is that farms are the safest security for long-term loans. Mansions may become boarding-houses, factories may become fit for nothing; but fertile, arable land has a value that rests upon mankind's most elemental needs and fluctuates only with civilization itself. Agriculture preceded and will survive every other industry in this country. Consequently a landschaft can accept with perfect safety only farm mortgages as security, and it should leave properties of other kinds and short-term loans to institutions organized differently from it and especially equipped for handling them.

In Europe the landschafts are the only institutions, except public or semi-public land-credit banks, that grant extensively long-term loans to farmers, and they surpass such banks in their ability to transact this kind of business. Of all the European land-credit ideas importable into the United States, the landschaft idea is the best. Europe, indeed, has failed fully to appreciate its wonderful efficacy and has corrupted or neglected the institution in many countries, owing to lack of self-reliance on the

part of the peasantry. Purified and modernized, the idea would take on a renewed vitality among self-reliant American farmers and enable them always to obtain loans at fair interest rates and on easy terms. But, contrary to the frequently repeated error and hope, the rate would perhaps not go as low as that of government bonds. No credit instruments can equal those of government, based as they are directly on the taxing power for their redemption.

If a landschaft were established, the farmers of its district might or might not join it, as they liked. They certainly would avail themselves of this non-profit-making, non-dividend-paying institution, if they found or believed that the terms offered by companies or individual money-lenders were unsatisfactory; this would give rise to a healthy competition that would set rural finance right in that district. Indubitably it is to be preferred that only landschafts of the pure type be established in the beginning and that the consideration of their modification be left to some future time, if after thorough trial, the pure type should not prove to be adapted to this country. Moreover, it is very desirable that all states which establish landschafts should adopt the same type, so that their debentures may be of a standard quality and easily marketable in financial centers.

The drainage acts in the United States would afford helpful suggestions in formulating legislation for landschafts. Indeed, there is a striking resemblance in organization and administration between the old Prussian landschafts and the drainage districts in some of the American states. In Illinois, for instance, when it is desired to construct, repair, or maintain a ditch, embankment, or grade for agricultural or sanitary purposes and to apportion the costs among the parties to be benefited, a district may under the Act of 1885 be established therefor by the majority of the adult landowners holding in the aggregate more than one-third of the lands lying in the proposed district, or by the owners of the major portion of such lands who constitute one-third or more of all the landowners.

When an Illinois drainage district is established, the resident landowners elect three commissioners for one year, two years, and three years respectively. The term of office thereafter continues for three years The commissioners appoint the treasurer and other employees. The town clerk acts as clerk. The district may be divided into subdistricts, with subcommissioners elected in the same way as the commissioners of the main district. The commissioners and subcommissioners must be resident landowners; they are paid expenses and a per diem for actual services.

As soon as the commissioners have drawn up plans for drainage works, they proceed to make assessments for benefits, by classifying the lands in 40-acre tracts. The tract that receives the most benefit is marked 100, and the other tracts are graded accordingly. This classification is the basis for the levy of such taxes as may be necessary for the work. The commissioners then order such taxes to be raised by special assessment upon the tracts, and the amount is apportioned among the several tracts so that each tract bears an equal burden in proportion to the benefits. Appeals from the classification and assessments lie to the county court.

The assessments may be paid in instalments running for fifteen years from the date of levy. All assessments become a lien upon each tract to the extent of the proportionate share assessed or levied against it; however, such tract or its owner is not liable for more than such proportionate share and subsequent levies. In case an owner neglects to pay an

assessment or instalment, the commissioners may bring suit to foreclose the lien, or they may enforce the collection in the manner provided for collecting delinquent taxes.

The commissioners may on their notes borrow up to 90 per cent. of any assessment. Upon petition of the majority of the landowners they may also extend the time of payment of an assessment for ten years and issue bonds to run for one year after the assessment becomes due under such extension. The bonds are a lien on the assessment. Interest on notes or bonds must not exceed six per cent. a year. The bonds of an Illinois drainage district may be registered with the auditor of state. If such registered bonds are defaulted, the amount of the default is apportioned among the various tracts in the district and collected along with the taxes levied for state revenues.

Hence, it will be seen, an Illinois drainage district is, to a greater extent than a Prussian landschaft, created and officered by members. The officers have a public character and standing. The assessments in a drainage district are an indefeasible lien on the property benefited, and each landowner is liable for his proportionate share, exactly as is the case with the loans to borrowers in a landschaft. The district may issue bonds up to near the amount owing by the landowners on the assessment, while a landschaft may issue debentures up to the amount owing by borrowers on their loans. The liability of the landowners on the registered bonds of the drainage district, and of the members of a landschaft on its debentures is joint and several and unlimited; and any default is made good by assessments equal against all in both cases.

The difference between the two institutions is that the Illinois drainage district negotiates its bonds and uses the money for drainage works, while a landschaft turns its debentures over to its members to be used in raising money for individual loans. This difference in the use of funds, however, does not affect the remarkable resemblance in respect to organization and administration. Illinois is but one of the examples that might be cited. The drainage districts in the American states contain the basic principles of the landschaft. A law patterned after their acts would be highly serviceable for long-term lending on farm lands. The instalments or annuities which the borrowers contracted to pay could be made a lien upon their lands, exactly as the assessments for drainage works, and this would do away with the necessity of mortgages. All that would be required would be to take the notes or contracts of the borrowers, file these papers with the treasurer, and make on the records proper entries of this fact and of the assessments and payments.

CHAPTER V

BOND AND MORTGAGE COMPANIES

A bond and mortgage company is a corporation with a fixed capital stock, usually paid in. Its powers are to issue bonds or debentures and to make, purchase, deal in and sell loans on real estate. The administration and organization are similar to that of an ordinary corporation. Supervision is lodged in the banking department. Special acts of a monopolistic nature have been passed in some countries, but usually the incorporation is obtained under a general law which permits the formation of plural competitive companies. Loans may be made on any kind

of real estate, but a company may by its charter or by-laws confine its credit facilities to some particular class of borrowers.

There are many different laws on bond and mortgage companies, but they are all patterned more or less closely after the French legislation of 1852. This comprises a general law which applies to both landschafts and joint-stock companies and simplifies for them the methods of determining titles to real estate and of recording and foreclosing mortgages; and also a special act creating the *Crédit Foncier de France* (Land Credit Company of France) to operate under the general laws. The *Crédit Foncier* as it now stands, however, is a semi-public institution which enjoys a monopoly by reason of its connection with government and of a special privilege allowing it to award prizes at the redemption of its debentures. Furthermore, by successive amendments of its organic act, it has been authorized to receive deposits, to make loans to and issue bonds for municipalities, public establishments, colonies and states, and to finance drainage and public works. These functions now constitute the larger part of its business, and have done away with its pure land-credit character. Only those provisions of the French law which bear upon mortgaging need be mentioned here.

The *Crédit Foncier* has power to make to any landowners loans repayable at long term by annuities or at short term with or without amortization, and to circulate debentures not to exceed the aggregate of the sums owing by its borrowers. The capital stock, now $50,000,000, must always be maintained at one-twentieth at least of the funds realized on the debentures in circulation. One-fourth must be invested in government bonds and one-fourth in other securities designated by the law, while the remainder may be invested in loans. The shares, $100 each, carry no liability except for their face value, and can be issued only at par or at a premium. They may be registered or unregistered, but dividends are payable to bearer. The holder may make partial payments; he, his heirs, and his creditors are bound by the by-laws, and their rights are determined thereby. The *Crédit Foncier* cannot extend credit on its own shares.

The loans must be secured by first mortgage. Theatres, mines, and quarries are not mortgageable. The mortgaged property must be capable of yielding a durable and ascertainable revenue, and its perishable parts must be insured. Its value, estimated by the revenue and the selling price, must be maintained during the life of the mortgage. The amount of the loan must not exceed one-half of this value, or one-third for vineyards, orchards, nurseries and the like. The industrial use is neglected in appraisals of factories and manufacturing plants. The rate of interest is fixed by the board of directors, but must not be more than six-tenths of one per cent. over the rate actually paid on the debentures of the series current when the board fixed its lending rate. Defaults bear interest at five per cent. per annum, and besides render the entire principal exigible. The loan may also be recalled if the security becomes impaired or if the property be transferred or encumbered without the consent of the company. The borrower stands all the cost of the appraisal and of the making and recovery of the loan. The short-term loans run for nine years or under; they are payable in lump at maturity and prepayment is not allowed. The long-term loans run from ten to 75 years; they must always be reducible by annuities, and the annuity must be no larger than the revenue of the mortgaged property. Prepayment in whole or in part is allowed by payment of an additional three per cent. upon the sum so paid in advance; the charge at present is one-half of one per cent.

The *Crédit Foncier* issues its debentures in series, each of many millions of dollars, in representation of its long-term loans. The mortgages are not held in trust for their security. The money obtained by the issues of debentures should not exceed the amount of the outstanding loans; if there should be an excess, it must be invested in securities of the kind designated by statute until used in long-term loans. The debentures may be registered or unregistered, but the coupons are payable to bearer. No denomination may be smaller than $20. The rate of interest and times and methods of payment are fixed by the board of directors, but the date for payment of the interest must be three months after the date for the payment of the annuities, so that the company may be able to collect the dues from borrowers in time to meet its obligations to debenture holders. The debentures are not exempt from taxation, but they are lawful investment for fiduciary and public funds.

The debentures do not specify any time for the return of the principal; they simply state that they are redeemable by lot within some period extending to a distant date, and contain a clause showing how many drawings will be held and the amount of the prizes, if any, provided by the board of directors for the series, as in the following sample:

> Payable at par after withdrawal by lot within sixty years the latest from November 1, 1860, giving right to 3.75 per cent. interest per annum, half-yearly May 1 and November 1, and to participation annually in two lottery drawings with prizes amounting to 300,000 francs, conformably with annexed schedule.

This is in accordance with the law which permits the *Crédit Foncier* to issue debentures without fixed maturity and with premiums or prizes, and to defer their payment until withdrawn. At every drawing the necessary number of debentures must be retired so that those remaining in circulation shall not exceed the outstanding loans. An advertisement describing the debentures so retired is officially published; thereafter they cease to bear interest and upon presentation are paid and canceled. Debentures which the *Crédit Foncier* has purchased in the market or received from borrowers in lieu of cash may be reissued.

The amortizements of borrowers are carried to a sinking fund, from which the *Crédit Foncier* retires debentures by lot through periodical drawings at the intervals announced at their issue. The profits must be distributed as follows: five per cent. in dividends, from five to 20 per cent. in maintaining the obligatory reserve, and the remainder in dividends or in such other ways as the board of directors may decide; the board decides also how the reserve shall be invested or employed. This fund is used for emergencies, and especially to steady dividends; if profits are not sufficient for a five per cent. dividend, the difference may be made good out of it. Besides this obligatory reserve, the *Crédit Foncier* accumulates special reserves for paying premiums and prizes and for extraordinary expenses.

The French legislation of 1852 is far from perfect. It was modeled on the organic acts of the old Prussian landschafts. The framers, like the American investigators, mistook these district credit bureaus for associations, and wrought confusion by a wrong application of their principles and methods. Furthermore, France never gave its general law a fair trial, but stifled private enterprise and competition by creating in the same year by a special act its highly privileged monopolistic *Crédit Foncier* to operate in connection with government and to exercise various rights in addition to those accorded under the general law. France today is in almost as much need of a reorganization of land credit as the United States. Nevertheless, this French legislation was the starting point for bond and mortgage companies, just as the Silesian act

of 1769 was the starting point for landschafts, although the latter was not the first of its kind, as shown in Chapters IV and XI of our book on "Rural Credits" (New York: D. Appleton & Company).

Two simple, master clauses appear in all the best laws on bond and mortgage companies. They are: (1) capital stock and surplus must be maintained at a safe ratio to bonds or debentures; and (2) bonds or debentures in circulation must represent first liens on real estate of adequate value and must never exceed the outstanding loans in either amount or interest rate. Experience in Europe has proved that one dollar to twenty dollars is a sufficient ratio to protect the bondholders of a company against defaults of its borrowers if a fair proportion of the capital stock or a reserve, created out of surplus, is kept in liquid assets. The laws designate one-fourth of the capital stock or all of an obligatory reserve to be thus set aside as a guaranty fund to protect the holders of bonds and shares. The legal investment for this fund is the same kind of personal securities that are required for savings banks or the reserves of life-insurance companies in the United States. With this exception, a company may use all its assets, regardless of source, in its business, and distribute all its net earnings among stockholders. The rights of the stockholders are looked upon as favorably as those of the bondholders, since they are the ultimate guarantors of the risks and supply the first capital for the operations. There is no limit to dividends; the aim is profit and no restrictions are imposed, except such as safeguard borrowers from oppression and investors from fraud or recklessness. A maximum is prescribed for the capital stock so as to prevent monopoly, but inasmuch as the capital stock serves not only as a working, but also as a guaranty fund, and must be maintained at a statutory ratio to obligations, the amount is subject to increase or even diminution under the maximum upon approval or order of the supervising authority. Provision for this is made in the charter.

There are three distinct ways of utilizing the capital stock in connection with the bond-issuing power for financing operations. In France, the *Crédit Foncier* makes its short-term loans from capital stock and surplus, but finances its long-term loans by debentures. The debentures may be issued before making the loans, but if the company has overestimated its financial needs, the excess of money realized at the sales must be placed, pending its regular employment, in the Government's keeping or in the securities designated by the law. The free capital stock may be used in buying its own debentures or in covering the losses in the sinking fund occasioned by borrowers' defaults. These two clauses were suggested by the landschafts; the latter is of doubtful value. In Italy, the *Istituto Italiano di Credito Fondiario* (Italian Land Credit Company) makes its loans from free capital stock, then issues debentures to recoup the investment, and thus uses its capital stock as a revolving working fund. In Germany, the land-mortgage banks make the loans from any of their assets, trustee specific mortgages, issue bonds on that security in order to raise more money, and thus they use their capital stocks mainly as the final guaranty for their bonds and all other liabilities.

The observance of this diversity of methods becomes highly important in framing the provisions for the issue of bonds or debentures. Regarding the question of trusteeing, it may be said that if a company is empowered to use its funds for various objects (as in Germany), the instruments financing each object should have the service of a trustee for holding all the securities arising out of that particular object. On the other hand, if a company may use its funds for only one object, and

that object be mortgaging, the trusteeing is unnecessary since its only possible claimants are bondholders. It would not be equitable to classify the bonds according to series and give to one series a priority on some part of the company's assets, because every one of the bondholders contributed proportionately to its success; and if the company becomes bankrupt, they all alike should have corresponding rights in the winding up of its affairs. Trusteeing is cumbersome and expensive and adds costs to the loans; yet it cannot be safely avoided if various objects be allowed a company, and the practice will remain advisable in the United States for small companies until official supervision is improved.

As to large companies, the preference undoubtedly lies between the Italian and French methods; indeed, operations would be seriously crippled unless one or the other be adopted. The former, permitting no debentures or bonds to be issued in advance of the loans, is an adaptation of the landschaft idea; it is theoretically correct and inherently safe. But while it is entirely satisfactory for the landschafts, which use only their credit in making loans, it presents difficulties for companies that must make their loans in cash, and consequently ought to have a steady inflow of funds for the easy extension of business. The French method makes this possible; nevertheless, it is theoretically wrong and very dangerous, and should be tolerated only in conjunction with absolutely perfect official supervision. This France has accomplished by requiring proceeds from debenture sales to be placed under Government control, pending their regular employment. The *Crédit Foncier* determines its future financial needs from loan applications already filed or on the basis of probable demands as estimated by past experience, issues its debentures in enormous series of $50,000,000 or $180,000,000, finds underwriters for them among banks and syndicates, and in this way takes advantage of favorable market conditions and obtains money on the easiest possible terms for its borrowers.

Different from landschafts, companies always issue their bonds or debentures in series; the separate pieces may be of various denominations, but all must bear the same interest rate. The maximum for the rate is governed by the general laws on usury, but the actual cost of the money and the length of the period for the series depend, of course, upon the condition of the market at the time of issue and upon the confidence which the public has in the company's standing and officers. With permission of the supervising authority, a series may be issued below par, but the permission is granted only in extreme cases, since the redemption would reduce either the capital stock, reserve, or surplus. The issue below par of debentures bearing the highest rate of interest is a risky and usurious practice to which no moneyed corporation ought to be allowed legally to commit itself. Each series constitutes in its entirety a single, distinct debt of the company, and may be issued only upon application approved by the supervising authority, who must assure himself that it will not disturb the statutory ratio between obligations and capital stock and surplus, that its proceeds will be invested or deposited in the ways prescribed by law, and that it does not exceed the loans it represents either in amount or in interest rate; the latter point is extremely important, for otherwise the company might consume principal in paying interest and impair the security. If the law under which the company operates requires that the mortgages be trusteed, a fiduciary appointed by the supervising authority acts as custodian of the trusteed mortgages, countersigns every bond issued, destroys redeemed bonds, and exacts from the officers a strict performance of their duties. The fiduciary is paid by the company or companies which he serves.

Bonds and debentures are always made subject to recall at the will of the maker. They may be bought by the issuing company at the market quotation, whether this be above or below par, but the best laws do not require the company to accept them from borrowers in lieu of cash. The use of these instruments for cash is, as shown above, compulsory and entirely equitable in the case of a landschaft, since this institution makes its loans in debentures and the borrower must stand the loss if its credit is at a discount; consequently it is only fair that he should benefit by any premium on that credit. Moreover, a landschaft has no need of profit; its aim is solely to accommodate borrowers, cheaply and satisfactorily, and it is rather to its advantage that borrowers should present debentures instead of cash, since this saves it trouble and expense in redemption. But a company, on the other hand, makes its loans in money. The loss falls on the company if this money was obtained by selling its bonds or debentures at a discount. Moreover, a company has shareholders who have assumed all the risks incident to its business; they must be accorded equitable treatment, in order to induce them to subscribe to the capital stock and supply the first fund necessary for operations. Hence, if the bonds or debentures are quoted above par, the premium on its credit should be available for increasing surplus or reserves. Thus, the acceptance of tenders of its own instruments in lieu of cash from borrowers becomes an act of grace on the part of a company, a favor that it cannot conveniently extend for borrowers' annuities, or even for any other kind of repayments, unless the interest rate on the bonds or debentures is lower than, or no more than equal to, the rate of the loans on which they are tendered. France has corrected the error, resulting from confusing landschaft and joint-stock methods, that it made in this matter; the United States should avoid making it.

In land-credit parlance, a bond is quite different from a debenture. A bond is a promissory note with a given date for maturity; it is always secured by trusteed mortgages, and never used except for short-term mortgaging. A debenture is not secured by any specific property; it is a floating charge on all the assets, or rather a naked acknowledgment of debt for a certain sum with no date fixed for payment, or else it is made redeemable at any time within a given period which may extend to a very distant date. The debenture is used only for long-term mortgaging. The same company may do both a short- and a long-term business, but if it exercises this power, the two operations should be kept separate from one another, and the bonds should be made different in form and color from the debentures, so that investors may know at a glance which of the two they are buying, while the fiduciary (appointed by the supervising authority) should see that the mortgages representing the bonds are segregated from the rest of the assets and properly trusteed.

It will be seen, therefore, that the debentures have no other security than the general standing of the issuing company, and by their wording involve the company in practically no liability except for the payment of interest; holders have no claim for principal which they can enforce against the company until it is willing, or rather ready, to meet it. This form is absolutely necessary for the long-term mortgaging the debentures are intended to finance, because an obligation for paying money cannot be safely entered into if it calls for payment faster than the money can be earned or recovered; and this would be the very case if an attempt were made to grant long-term loans out of funds raised by short-term bonds. The debenture is the corollary of the long-term loan, and long-term lending is impossible without it. The business of buying annuity

contracts from borrowers, that is, the making of long-term loans reducible or amortizable by annual or semi-annual instalments, cannot be extensively practiced by banks or companies that have only their own funds or deposits to lend. The investment is so long and the refunding so slow that it would immobilize their assets and eventually reduce such banks or companies to inactivity. Nor would it be practicable for individual money lenders or small concerns to take back their principal in driblets, as it is earned bit by bit by the borrowers from the annual returns of the soil. The facility requires a specially organized institution with the power to issue and the ability to sell debentures in representation of the mortgages, and thus to recover and utilize the money placed in long-term loans in continual rotation for profitable reinvestment or for meeting its liabilities; but the bondholders should not have the right to repayment at a more rapid rate than is demanded of the borrowers. There must be a steady and voluminous flow of funds, inward and outward, a repeated turning over of these funds, in order to assure good dividends to stockholders and fair interest to borrowers.

Hence, all companies formed for long-term mortgaging have capital stocks sufficiently large to inspire public confidence and command an active market for their debentures, while their obligations to the holders of these instruments of their credit are not a matter of contract, but a duty resulting from provisions of the laws under which they operate. These provisions are: (1) the holders have a prior claim on all the mortgages; (2) the receipts from the mortgages must be placed in a sinking fund; (3) redemptions must be made periodically out of this sinking fund. The last provision was adapted from the landschafts, but with two modifications. Different from a landschaft, a company makes its loans in cash, and can use all its funds for this purpose regardless of source, except that part of the capital stock or reserve which is set aside as a guaranty fund. So a company is required to retire debentures at the periodical drawings only up to the aggregate amount of borrowers' repayments which it has not reinvested in new loans. The company may, by agreement, of course, undertake a larger retirement than this.

Again, a company is primarily and absolutely responsible for the defaults of borrowers; a landschaft is not responsible to this full extent, since it is obliged to turn over to debenture holders only what it has actually received from borrowers. Hence, in addition to currency on hand, a company at the periodical drawings should retire debentures up to the whole amount of its disposable cash in the sinking fund, increased by the defaults made by borrowers during the period preceding the period next before the drawing. This eliminates bad mortgages from among the securities, prevents funds from being misapplied or lying idle, and brings about an overhauling of assets and liabilities at regular intervals, thus applying to land-credit companies the same precautionary measures that are exercised by all properly managed moneyed corporations. The period between drawings is three or six months; and this in France and Germany is quite sufficient to enable a company to institute and finish legal proceedings to recover claims against delinquent borrowers in time to meet its obligations to bondholders.

Thus, besides the redemption of the debentures, the objects of the periodic drawing are to maintain their statutory ratio to capital stock and surplus and to preserve their equilibrium with the loans. Hence, at the redemption the interest rate is as important as the amount. For this reason, every drawing is made according to series, and its method and conditions are announced at the issue of each series and indicated in the debentures themselves. The drawings include bonds and debentures, if

the company issues both. Premiums may be granted, while in France prizes are added to attract investors and to compensate them for any inconvenience they may suffer from irregular return of their money. In the United States prizes would be unlawful. To quote from Montgomery Rollins, of E. H. Rollins & Sons, Boston:

> The City of New Orleans has premium bonds outstanding. They are of small denominations, and interest on them is not paid until they are withdrawn for redemption by lot; then the principal, together with simple interest from July, 1875, is paid to the holder. There are also prizes which amount to about $100,000, which are likewise annually distributed among those whose bonds are redeemed. These prizes or premiums range from $20 to $5,000. The United States Government has recently looked upon this as a lottery scheme, and has issued an order barring such bonds from the mail.

Without prizes, or at least premiums, debentures might be hard to sell at present in the United States. Indeed, debentures were distrusted at their introduction in every country; nevertheless, these instruments, although they contain no word about the repayment of principal and are liable to retirement at times when investors might not expect nor desire it, are absolutely indispensable for long-term mortgaging on a large scale. No workable plan for amortizing loans by annuities could be devised without taking them into account. Some other attraction must be substituted for the prizes that would be unlawful and for the premiums that would be objectionable. In Europe, debentures are a legal investment for fiduciary and public funds, and in several instances government was a heavy purchaser at the first issue. This was effective in removing distrust and creating popularity for the debentures; another and better way in the United States would be to subject the companies to rigorous official supervision and to require them to have such large capital stocks that there would be no question as to their financial standing.

The loans are made only upon written application, accompanied by the necessary papers to show the applicant's civil capacity and his title to the property offered as security, passed upon by a credit committee and approved by an executive officer. The applicant is not required to be the occupant or cultivator of the property; a company may grant loans to any landowners regardless of their vocation or profession, unless by its charter or by-laws it has chosen to confine its credit facilities to some particular class of borrowers. The loans are not restricted to some specified and sworn-to purpose, as provided by nearly all the bills pending in Congress. Such a clause does not appear in any European laws on bond and mortgage companies or landschafts, nor even in the charters of many public or semi-public land-credit banks. To purchase, equip, improve, or of a prior debt to disencumber the mortgaged property are not the only good reasons for borrowing. Such a narrow restriction would be paternalistic and repellant to self-reliant American farmers. Moreover, it would be difficult for the courts to construe and for the companies to carry out. It would cut both ways; it might render the loan liable to recall at the company's will, or else require so much time and care in making and watching the loans that the business would be expensive to borrowers and unprofitable to lenders. This inquisitorial and impractical clause, which would increase costs, cause irritation and probably fail of success, has found favor with American legislators simply because they have got government intervention mixed up with private initiative.

The interest rate on loans is governed by the general laws on usury. If there be any other rule, the maximum is determined by the rate borne by the current series of bonds or debentures, and may not exceed that rate by more than six-tenths of one per cent. A maximum for

amount of an individual loan is not prescribed; but if a limit is fixed, it is usually one-twentieth of the capital stock and surplus of the company. Every loan, or annuity contract, must be secured by a mortgage or some other instrument giving a first lien on real estate. The laws, however, are of a general nature and do not require that this real estate, or the owner thereof, shall belong to some particular class; that is a matter which is left to the charter or by-laws of the company. The laws are concerned only with the adequacy of the security; they differ widely from one another on this point, but none permits the borrowed sum to equal the full value of the real estate. Some restrict it to 60 per cent., others to 50 per cent., while all lay down specific rules for appraising the property and for preserving the security from depreciation. In long-term loans the revenue as well as the value of the land is taken into account; the annuity which the borrower obligates himself to pay must not be greater than the revenue, and this revenue must be certain and durable.

In Germany and Austria, the appraisal is not difficult because each of those countries taxes real estate on its revenue, instead of on its value as does the United States. The figures of the tax assessors are available for the appraisers of the company; they multiply the officially ascertained revenue by ten, fifteen, or twenty-five, and, after certain deductions, use the multiple, or a part thereof, as their estimate of the lending value of the land. This makes the appraisal automatically correct. In other countries the personal equation cannot be eliminated from land credit, since the appraisers must depend upon their own judgment. The value, no matter how ascertained, must never fall below the amount outstanding on the loan during the continuance of the mortgage. Perishable parts of the property must be insured and kept in good condition. If the property be a farm, it must be properly cultivated and supplied with sufficient live stock and equipment. Moreover, the borrower must pay the taxes and insurance premiums promptly and repair damage resulting from any except natural causes or wars. But many of these are contractual and not statutory engagements; they arise from clauses in the mortgage, for any breach of which a company may take possession of the property or foreclose upon it, exactly as in the United States. A company usually reserves the right to recall the loan if the borrower assigns or encumbers the mortgaged property without its consent.

*The maximum period for loans is usually 75 years; but there is no reason why it should not be 100 years, since the problems and tables

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* Among the best books on long-term operations and annuities are the following:
George King, *The Theory of Finance* (3d ed.; London, Charles and Edwin Layton, 1898). This is a short treatise on the doctrine of interest and annuities-certain.
M. A. Mackenzie, *Interest and Bond Values* (Toronto, Canada, University Press).
J. A. Archer, *Compound Interest, Annuity, and Sinking Fund Tables* (London, Shaw & Sons).
Ralph Todhunter, *Principles of Interest, Life Annuities, and Assurances, and their Application* (London, Charles and Edwin Layton); Part 1, *Interest*, including annuities-certain. This is the text book of the Institute of Actuaries.
P.-A. Violeine, *Nouvelles Tables pour les Calculs D'Intérêts Composés, D'Annuités et D'Amortissement* (8th ed.; Paris, Gauthier-Villars, 1903).
F. Vintéjoux, *Nouvelles Tables D'Intérêts Composés et D'Annuités et Précis de la Théorie et de la Practique des Operations Financières à Long Terme, Particulièrement des Emprunts* (Paris, Librairie Scientifique, A. Hermann, 1905).—Copyright in the United States owned by Myron T. Herrick and R. Ingalls.
Simon Spitzer, *Tabellen für die Zinses-Zinsen und Renten-Rechnung mit Anwendung derselben auf Berechnung von Anlehen, Konstruktion von Amortisationsplänen*, etc. (5th ed.; Vienna, Verlag von Karl Gerolds Sohn, 1911).
George T. McCaw, *Tabular Aids to Valuation* (London, Crosby Lockwood & Son).
Clarence A. Webb, *Valuation of Real Estate* (London, Crosby Lockwood & Son).
H. G. Lamputt, *Notes on Valuation of Real Estate* (London, Crosby Lockwood & Son).
William Schooling, *Inwood's Tables of Interest and Mortality for the Purchasing and Valuation of Properties* (London, Crosby Lockwood & Son).

have been worked out up to that many years by authors of standard books published in the English as well as in other languages. The longer the period the smaller the annuity; so ordinarily the borrower selects as long a period as he can get, with the view of adjusting his annual dues to the capacity of himself and the mortgaged property for repayment. It is the size of the obligatory annuity that governs the borrower's choice, since he may voluntarily shorten the period through his right to make payments in advance. But, on the other hand, the period is of first importance to the company, and the number of years that may be afforded depends, of course, on the terms and conditions of the debentures by which the money for lending is raised. The free play of amortization ought not to be interfered with by the 35-year maximum proposed by most of the bills pending before Congress. In Europe, none of the big companies finds any trouble in extending the maturities of its obligations to very distant dates, while many a man with pride of family has established his son as a landed proprietor by a loan that was intended to be borne in part by the future generation.

If a company makes loans at both short and long term, it must maintain a separate department or section for each business. The short-term loans are made from capital stock and surplus, and with money coming from bonds secured by trusteed mortgages. They run from one year up to ten years, and each is represented by one promissory note for the entire amount, or by a number of promissory notes of equal or unequal parts of that amount, falling due at successive periods, with the larger notes maturing in the later years when the interest payments are less. Since prepayments are almost unnecessary, their acceptance is optional with the company. Long-term loans may be made also from capital stock and surplus, but after these funds have been invested, the laws require that such loans must be financed exclusively by debentures without fixed maturity or specific security. They have a statutory prior lien on all the assets and resources of the company, unless the law has empowered it to set aside and trustee a portion for its bonds. Long-term loans run for ten years or over, and must always be repaid by annuities. The annuity is payable semi-annually in cash.

The annuity of a joint-stock company is quite different from that of a landschaft. The latter (as shown above) comprises: the interest on the debentures in which the loan was made; one-fourth or one-half of one per cent. of the original amount each year as long as the borrower remains a member of the landschaft; and a contribution to the cost of business for the first ten or fifteen years, or until the expenses of the loan are wiped out. The annuity in a joint-stock company, on the other hand, remains level during the whole loan period, and cannot be altered except with the consent or upon the default of the borrower; it comprises but two items—the interest and the amortizement; the amortizement is determined by the rate of the interest and the duration of the loan. The reason for discarding in the computation the landschaft's item for cost of business is that this is included in the interest, out of which the company both pays its expenses and realizes its profits.

In the mathematical calculations of annuities, the first question is: What will one dollar set aside each year amount to at the end of a certain term? This amount, for instance, would be $36.78 in 20 years at six per cent. But if this amount were actually lent, the borrower would have to pay interest as well as to set aside the one dollar each year to repay the loan. One year's interest on $36.78 is $2.21. Consequently, the total annual payment would be $3.21; and out of this level annual sum the interest and the instalment on the principal may be paid.

The principal instalments would be in constant danger of being diverted from their proper use if the borrower should undertake to keep them under his control. Moreover, it would not be an easy matter to invest these small sums profitably. Therefore, the best way is to apply them on the loan immediately after their receipt. This is what the company does, and by so doing it not only reduces the loan, but also, as a consequence, it reduces future interest charges, and leaves a larger portion of the annual payment for use toward the liquidation of the debt. The following table illustrates the process in this case:

End of Year.	Interest payment.	Capital payment.	Capital repaid to date.	Capital Outstanding.
1	$2.21	$1.00	$1.00	$35.78
2	2.15	1.06	2.06	34.72
3	2.09	1.12	3.18	33.60
4	2.02	1.19	4.37	32.41
5	1.95	1.26	5.63	31.15
6	1.87	1.34	6.97	29.81
7	1.79	1.42	8.39	28.39
8	1.71	1.50	9.89	26.89
9	1.62	1.59	11.48	25.30
10	1.52	1.69	13.17	23.61
11	1.42	1.79	14.96	21.82
12	1.31	1.90	16.86	19.92
13	1.20	2.01	18.87	17.91
14	1.08	2.13	21.00	15.78
15	.95	2.26	23.26	13.52
16	.81	2.40	25.66	11.12
17	.67	2.54	28.20	8.58
18	.52	2.69	30.89	5.89
19	.35	2.86	33.75	3.04
20	.18	3.03	36.78	Nil

In long-term loans, the default of one annuity renders the entire debt due, and interest in excess of the contract rate may be charged on the unpaid amount; prepayments are allowed, but only upon paying an extra percentage on the prepaid sums. These charges are high, the maximum for the latter being three per cent., and necessarily so, because defaults and prepayments upset the plan agreed upon for the extinction of the debt and require its amortization to be completely recalculated. A long-term loan is not evidenced, like a short-term loan, by a promissory note; it is an annuity contract. The lender buys from the borrower an annual income for a stipulated period; the sum lent is the consideration for that income and the mortgage taken for security makes it a rent charge against the property. Now, if a borrower, wishing to clear off a part of this obligation against himself and his mortgaged property, tenders some money for the purpose, what may be done with that money? Clearly it cannot be used to reduce the original amount of the borrowed sum (as in the case of a short-term loan), because there is no promissory note or negotiable instrument on which payments may be indorsed. The borrower's debt is the balance entered on the company's books against his account in the sinking fund and equals the present worth of a series of deferred payments, computed by the rate of interest which the company charged for taking the risk and making the loan.

The lender could, of course, receipt the borrower for a number of annuities equal to the amount of the money; but then the borrower

would forfeit the interest computed in those annuities unless the lender should extract it. On the other hand, the interest rate would undergo a change and might become usurious if the lender should accept a prepayment and yet leave the future annuities to remain the same as originally contracted for. So, in Europe, there are laws which provide that a prepayment may be applied to reduce the amount of the annual income or annuity without changing the date for final extinction of the loan; or else to increase the amount, and thus reduce the number of the annuities and shorten the period of the loan. In Germany, after the borrower has paid off one-tenth of the principal, he may even demand a fresh scheme of amortization which may change the size of the annuity, or extend the term beyond the date set by the original agreement; yet, in spite of these alterations in the original contract, the mortgage remains a valid lien on the property against third parties. This appears to be the case, also, with rearrangements made in consequence of defaults; the company may apportion the default among all the unpaid annuities and increase their size without affecting its lien under the mortgage. This, however, is a legal point which calls for further investigation.

In the United States, any such alteration of the original contract might impair the lien of the lender under the old mortgage, if in the meantime rights of third parties had attached to the mortgaged property. Existing laws certainly would not permit an extension beyond the original term against the rights of intervening third parties. Moreover, the courts might construe an agreement to pay a series of annuities as one entire and single contract, and decide that any alteration of it in either amount or period would invalidate the old mortgage. If so, the lender would have to take a new mortgage at every alteration; and this would necessitate a reëxamination of title and other acts, involving more or less expense that would have to be borne by either the lender or borrower. Such trouble and expense would make long-term mortgaging difficult and almost impracticable for ordinary amounts. A long-term loan would be a burdensome charge if the lender had to foreclose upon the default of just one annuity, or if the borrower could not get rid of it except by paying off the whole amount. Besides these difficulties which militate against the acceptance of prepayments and leniency for defaults, there are others, arising from the absence of statutory provisions in the United States at present that interfere with the equitable taxation and the proper registration of mortgages for long-term loans. For long-term mortgaging, a fee paid at the filing should take the place of an annual tax, while the mortgagee should be required to record at intervals the reductions made on the debt, so that the public register may show the actual state of the lien against the land.

The few lenders who have attempted long-term mortgaging in the United States have fully appreciated these legal and practical difficulties. For the purpose of avoiding them, the mortgage is drawn to secure a certain number of principal notes, and the only prepayment allowed is the paying off the whole or a part of these notes in advance of the due date. Nothing is said in the body of the mortgage about the method of calculating the amounts of these notes, while interest is charged and runs against their unpaid balances. Consequently this instrument is not an annuity contract; it is simply an ordinary instalment mortgage. No other arrangement, perhaps, would be advisable in the face of existing laws.

A pamphlet of the *Crédit Foncier de France* details the theory and the advantages of long-term loans in a brief but graphic manner, that may be condensed as follows: Through this system the French company

offers loans at long term repayable by annual fixed sums, called annuities, which comprise the interest at the agreed rate for the sum borrowed and an amortizement that extinguishes the debt within a period of from ten to 75 years, according to the plan that is selected. Since this amortizement reduces the principal at each payment, the part of the annuity which represents the interest decreases also; hence, the borrower will (if he promptly pays his dues) see the principal of his debt grow steadily less by reason of these payments, by a progression that is slow during the first years, but which advances rapidly during the latter years. The company thus permits the borrower to free himself gradually of his debt, as he recovers it bit by bit from the annual returns of the mortgaged property. He does not worry over a debt all falling due at once; indeed, he does not pay back the full amount of the principal. This makes the reducible long-term loan peculiarly advantageous to the landowner who borrows to purchase, improve, or equip his property, inasmuch as money invested for such purposes cannot be recovered except year by year. This example will explain the process of amortizing long-term loans:

Let us consider a loan of $10,000 at 4.30 per cent. payable in 30 years by 60 semi-annual instalments. The annuity is $596.44, or $298.22 the half year. In this latter sum are comprised at the first payment:

$215.00	for semi-annual interest ($10,000 @ 2.15%).
83.22	for the amortizement on the principal.
$298.22	

The principal remaining at the end of this first six months will be $10,000 minus $83.22, so at the end of the second six months interest is paid on but $9,916.78, and the second semi-annual annuity comprises:

$213.21	for semi-annual interest ($9,916.78 @ 2.15%).
85.01	for the amortizement on the principal.
$298.22	

The principal unpaid will be $9,916.78 minus $85.01, or only $9,831.77. At each successive six months a small part of the principal is thus repaid, and as a consequence the portion of the annuity used for interest continually decreases, while conversely the portion used for principal continually increases. The reduction of the principal, slow at the start, accelerates little by little, until it is very considerable during the latter years. So, at the end of the twenty-fifth year, the fiftieth semi-annual payment comprises:

$62.22	for semi-annual interest.
236.00	for the amortizement on the principal.
$298.22	

The principal unpaid is then $2,657.90, and at the end of the thirtieth year it will be entirely extinguished.

The advantages of long-term loans reducible by annuities are manifest to the borrower. By paying each year a sum which is apparently only the interest rate, he acquits himself bit by bit of his debt, while, if he makes no default, the company can never recall the loan, nor increase its interest, nor demand its payment at a more rapid progression than

stipulated in the original contract. But the borrower may pay off the loan whenever he is able and willing to do so; the company will even accept partial payments, and diminish the size of his annuities accordingly. Moreover, it may be more lenient than ordinary lenders, since it can alter the original contract in the event of default, without impairing its lien when once the mortgage has been made and recorded under the special proceedings provided for licensed companies. If the borrower should die, the contract continues to his heirs, but all they will owe is the principal reduced by payments already made. Progressive extinction of the debt, with the principal never recallable by the lender, but always repayable by the borrower, are the characteristics of the long-term loan reducible by annuities; while the longer the period the smaller is the annuity. For a loan of $100 at 4.30 per cent. (the rate of interest now charged by the *Crédit Foncier*) the annuities are as follows:

For a period of	10	years	$12.409
	20	"	7.504
	30	"	5.964
	40	"	5.259
	50	"	4.881
	60	"	4.663
	75	"	4.484

CHAPTER VI

RURAL COÖPERATIVE BANKING

Pure coöperative land credit is a rarity. Even the building and loan associations, which are financed entirely through coöperation, do not exact collective liability from borrowers. Such liability appears only in the landschafts, which may enforce it by assessments equal against all borrowers to maintain the sinking fund at a balance with outstanding debentures; and yet the landschafts are public institutions rather than coöperative associations. The infrequency of pure coöperative land credit is owing to the fact that borrowers are disinclined to assume one another's risks on long-term operations where mortgaging is difficult or dangerous, while there is little need for them to do so wherever the laws have perfected mortgaging, since real estate then becomes so near to being an all-sufficient security that the loan upon it requires no further guaranty, corporate, collective, or individual (aside from that of the owners), for repayment. Coöperation shuns danger and never appears except where there is a necessity for it. The reason why building and loan associations exist is because they are the best medium for utilizing savings to acquire homes in towns and cities; and the reason why landschafts exist is because they are the safest and easiest agencies through which farmers may obtain long-term loans.

This same reason of utility explains why rural and urban coöperative banks are constantly increasing in number in every country where they are empowered to receive deposits subject to check and to handle short-term paper on security other than real estate. A coöperative bank cannot be surpassed as a means for organizing the purchasing and selling power of farmers, while it is remarkably successful in encouraging thrift

among wageworkers; neither can it be surpassed for supplying the financial needs of small industries whose lines of credit are not desirable for commercial banks. But there are depths to which it cannot reach. Contrary to a belief widely prevalent in the United States, it cannot make character credit out of groups of paupers. The marvels done for thriftless impecuniosity by coöperative banking are largely imaginary. In Europe the average member of a coöperative bank belongs to as high a grade of society as that of depositors or members of American savings banks and building and loan associations. Indeed, he is somewhat more active than the latter, because he has joined his coöperative bank with a view to utilizing all its facilities in the business or vocation in which he makes his livelihood.

Many of the erroneous beliefs that are current about coöperation arise from the false notion that it is a benevolent or altruistic means for assisting distress or incompetency. This half-truth is alive with dangers. It is written in the recently enacted laws on the so-called credit unions, ruining them for farmers. It is printed in most of the popular literature that has been published, increasing the clamors for state aid and benefactions that have confused and belittled the rural-credits movement. Coöperation does not require the guiding or indulgent hand of government or charity, nor can it be forced into being in the absence of need for it, or long prevented if the need exists. It can help only him who is able and willing to help himself, and his neighbor also. It demands the spirit and the ability both to give and to receive, and it can attain enduring usefulness only among persons who are capable and honest and known to be so, who ask no favors, spurn subsidy or alms, and rely solely upon their own collective strength. Coöperation is eminently practical, for it is simply a method of business or finance. It may appear, of course, in a combination or consolidation of properties, but its literal interpretation is "working together," and it presupposes united action on the part of intelligent beings voluntarily associated for carrying on some object in common. Further, that object must give promise of material benefit to all concerned, for ordinarily one will not help others unless by so doing he can help himself. The basic idea is organized mutual self-help for profit among associates acting on their own initiative and depending on their own energies, talents, toil, and resources. True, coöperation is serviceable for the weak and poor as well as for the strong and rich, but the thriftless and incompetent are the ones whom it is least able to aid.

Coöperation is practiced by all classes of persons, in every conceivable activity, and under every known form of organization. It may be practiced in a partnership or through a corporation, but its spirit and method can best be preserved in an association. Prussia was the first country to give general recognition to this fact. The year was 1867—not long ago. By an enabling and regulatory law, she then empowered associations to carry on nearly every kind of business and finance, banking included, relating to agriculture and small industries. In 1871 the German Empire adopted this law, and furthermore permitted associations to combine in unions and federations. Soon thereafter rural coöperation literally swept the land, and the German farmers became able, almost without importations, to feed and clothe sixty-five millions of population from a not over-fertile area about the size of Texas. Within twenty years after the Prussian law was enacted a legal status was given to economic associations also in Austria, Russia, Italy, France, Denmark, and elsewhere; and in every instance the growth in the number and strength of the associations was so rapid that frequently statisticians were unable

to keep the figures up to date. This was why the German law authorized the unions or the local courts to appoint the official inspectors and auditors. The German law also contained specific and adequate provisions for banking and gave full play to collective credit and liability from the start, a point which some of the other countries overlooked and, in missing it, left an obstacle against the easy expansion of associational coöperation.

The difference between a private corporation and an economic association is this: the former is a joint-stock company of which the capital stock is fixed by the charter, paid in at the start and voted by the stockholders according to their shares, but owned by the company itself. Shares may be transferred or they may fall with all rights and voting power into the hands of heirs or creditors. Consequently, unless he be an officer or director, a stockholder's relation to a company is merely that of an investor; he is interested mainly in its profits and losses, and feels no personal responsibility for its acts or condition. An economic association, on the other hand, is a form of organization in which the equality and personal responsibility of the members are preserved. A mutual personal relation is established among the members and between them and the association by admission to membership exactly as in a social club. The law requires an association to specify in its articles of agreement the qualifications for membership as well as the area within which it must maintain its headquarters and confine its operations. So an association has both a personal and a local character, and it would lose its identity if it should move from its area unless its members followed it. Moreover, it has no capital stock; it could not have one without becoming a company. The so-called capital stock, which sometimes exists, belongs to the contributors, and each may withdraw his portion thereof upon due notice. Hence, an association may begin without a cent; its funds accumulate as it grows. It is because no money need be put up at the start and because all money put in is withdrawable that an association is more attractive than a joint-stock company to small investors.

If shares are issued by an association, they are non-transferable, and their voting power is so restricted that no one member or group of members can gain control through the mere might of money. Usually the shares are simply deposit certificates or obligations to make periodic deposits, while the voice of each member is determined by his standing and is limited to one vote at the balloting. In nearly every general law on associations, the provisions for formation, administration, management, and dissolution are the same for all kinds of economic associations, commercial, industrial, or financial, with the necessary modifications for banking. Not only uniformity, but also simplicity, is provided for, so that anybody who joins an association may easily understand his rights and duties, no matter what may be its purpose. A coöperative association may be defined as a voluntary union of persons for utilizing their collective energies or resources (or a part of them) under their own management, in some economic enterprise carried on upon their common account with a view to their mutual and individual benefit. A bank, then, which has an associational form and confines its credit facilities to members, is necessarily coöperative. A bank which has a capital stock cannot be coöperative, even though it confines its credit facilities to members, unless its charter provides that it shall be managed by officers elected by members voting under some plan that gives the control at elections to the majority, whether they own or do not own most of the capital stock.

So a coöperative bank may be either a corporation or an association; but the latter form is simpler, more in keeping with coöperation, and much to be preferred. There are two kinds of associational coöperative banks, just as there are two kinds of associations—one that issues shares and one that does not issue shares. Shares may be payable upon subscription, in which case they are small, i.e., ten dollars or under; while the number which may be held is unlimited, but the number which may be voted is limited usually to ten in the hands of one holder; or the shares may be payable in periodic instalments, as in a building and loan association, in which case they are large, ranging up to $1,000 apiece, and no holder may vote more than one or subscribe to another share until his first is paid up. But the same bank cannot issue shares of different kinds or denominations, since simplicity is always observed. All shares are entitled to dividends according to the payments made on them, but on instalment shares the dividends are used to mature the shares, and are not paid in cash as long as any instalment is owing. The credits on matured or paid-up shares are withdrawable on two months' notice. Consequently, the capital, if any, is variable, being liable to diminution through such withdrawals, or capable of indefinite increase by the issue of new shares or by payments on shares. Thus the capital is not owned by the bank, but is owned entirely by the contributors, subject to regulations regarding withdrawals.

Only persons admitted to membership may hold shares. Membership is open to other coöperative banks, associations, or companies, and to all natural persons residing within the bank's area and having the necessary qualifications. The regular meetings of the members are held annually; special meetings, upon call in the manner prescribed by law. Voting by proxy is strictly prohibited. The majority of those present prevails at elections, but a vote of two-thirds or three-fourths of all members or of outstanding shares is required for a voluntary dissolution or an amendment of the by-laws or articles of agreement. The admission or expulsion of members may be delegated to a body of executive officers, but the final decision rests with the members at a regular or a duly called special meeting. A member may voluntarily retire at the end of a fiscal year, after giving two months' notice. An expulsion or retirement works the surrender of shares; the holder is paid what is due him thereon and they are cancelled, but his liability as a member continues for two years thereafter. In a bank without shares this liability may be unlimited, i.e., a creditor of the bank may hold members personally liable and sue all or any of them; or the liability may be contributory, i.e., the bank or its receivers may levy assessments equal against all members and repeat the process down to the last financially responsible member, until all its debts are paid. In a bank with shares the liability is invariably limited, and runs in favor not of its creditors directly, but only of the bank and its receivers; they may call immediately all that yet remains unpaid on a share, or assess any member on his share up to the specified multiple of its face value. In practice these assessments are rarely made except equally against all, and so are contributory. A person who belongs to an unlimited liability bank cannot become a member of a bank of the other kind.

The administration of a coöperative association or of a bank always consists entirely of members annually elected by the members or subject to removal by the members at a meeting regularly held or specially called for the purpose, with, however, one exception: the inspector who examines and audits its condition and accounts is a non-member appointed by the local court or by the union (group of associations) to which the

bank belongs. An inspection must be made once every two years; it may occur oftener and as a surprise. The report of the inspector and the annual report of the officers must be filed with the clerk of the local court and published in an official newspaper. A coöperative bank has a board of two or more directors; they appoint the president from among their number, and select the other officers from among the members. The bank has also a committee of three supervisors, which has power to set aside any act of the board and to suspend any director, officer, or member. No person may serve on both the board and the committee at the same time, nor may credit be extended to any director, officer, or supervisor or upon his indorsement, without the consent of members obtained at a meeting. A bank may also have a finance committee. Salaries and compensation may or may not be allowed. Officers are appointed for one year. Directors and supervisors may be elected for three years, but then the terms are so arranged that one each on the board and on the committees expires annually. Fees on entrance may be exacted and fines for defaults or remissness may be imposed.

A coöperative association may have one or more objects; that is, if its articles of agreement so provide, it may be a bank with a trading feature and do collective buying and selling for members, besides extending credit to them. The banking powers embrace every banking operation except the right to issue notes. The only restriction is that it cannot extend credit to non-members, but it may receive savings from them. So it finances itself by deposits and savings from members and outsiders, by the issue of shares (if this plan is adopted), and by the use of its own credit. It may make short-term loans to members, subscribe to shares and buy bonds of other coöperative banks, associations, or companies, and invest in securities of certain kinds designated by statute. Loans must be secured. Real-estate mortgages are not taken, except to secure endangered claims. The only real estate that may be held is an office building. The profits may be distributed as dividends or rebates, or written to the reserve. If the articles of agreement so provide, all or a part of the reserve may be set aside as an indivisible permanent foundation, which, in the event of dissolution, shall not be apportioned among members with the rest of the assets, but turned over to the bank's union or to the state for the creation of another coöperative bank in the same locality. Bankruptcy proceedings must be instituted against an unlimited-liability bank when its assets and reserves do not suffice to cover its debts; and against a limited-liability bank when its debts exceed the assets and reserve and the fourth of the liability assumed by members on their shares. A bank of either kind must be dissolved also when the number of members falls below the minimum for organizing it; this is usually seven. Tax exemptions are not accorded to coöperative banks, nor to savings or deposits therein. The only privileges of a special nature are perhaps a reduction of stamp duties on their negotiable paper and cheap and simplified procedure for organization and dissolution.

This outline shows the trend of foreign legislation bearing on coöperative banking. The laws differ in details and at important points and cannot be harmonized. Some were framed by social reformers more benevolent than practical; others are compromises with legislators who opposed innovations and insisted upon share capital, as in Germany; while many contain clauses to meet conditions peculiar to country, or were enacted without a full understanding of coöperation's inherent relation to the associational form of organization. Not one of the laws is perfect or could serve as a model here. Nevertheless, notable progress has been made under some of them in the small industries and agriculture; and

in these coöperation always appears when once the ways have been pointed out and legal obstacles removed, since its natural medium is among persons each of whom has a business of his own through which he makes his living by manual labor or the personal management of his affairs. This gives rise to a necessity and also to assurances of safety, both of which are essentially precedent to the practice of coöperation. Wageworkers and clerks can be interested in coöperative banking only as depositors; a coöperative bank entirely composed of that sort would soon disband, because they have no need of credit except for a consumptive, or at best a provident, purpose while they can obtain as high returns on their money by investment in other concerns which would not, as a coöperative bank, subject them to the burdens and risks of the administration.

Coöperative banks can flourish only where their members are able to utilize in their own individual businesses the money and credit made available; and they succeed best when each business has a productive or creative character. In the cities the members are tradespeople, owners of shops and stores, grocerymen, butchers, tailors, shoemakers, fishermen with their own outfits, artisans and the like, together with skilled workmen and frugal and industrious persons seeking to save money and strengthen their credit standing with a view to setting themselves up in business. In rural districts, along with the farmers are the country-store merchants, blacksmiths, and persons engaged in agricultural pursuits; while both urban and rural coöperative banks, if the laws permit, may have investor members just as American building and loan associations. But the bringing together of active workers with the object of enabling them to make a more effective use of their money and credit in their own businesses is the chief purpose of a coöperative bank, and so it bears a closer resemblance to a commercial than to a savings bank.

The efforts being made in the United States to induce wageworkers and clerks to form so-called credit unions are hopelessly wrong; they are doomed to as bitter a failure as the other misguided efforts to repair through collective credit the fortunes of thriftless incompetents. Indeed, those wishing only investment should be discouraged from depositing their savings in a coöperative bank until it has established itself in a strong financial position; such persons should, until then, patronize savings banks and building and loan associations—not credit unions. A coöperative bank should be left to win its own way without being forced into uses for which it is not intended. At the start the only members should be those who expect actively to avail themselves of its resources in their own businesses, and nobody should ever be allowed to join it unless his presence will add to its strength and standing. A carefully selected membership is indispensable for the success of a coöperative bank; and for this reason the law requires each bank to prescribe the qualifications for admission and to permit expulsion at the will of the majority.

Membership in an urban coöperative bank is usually open to all reputable persons, irrespective of class or trade, although there are instances of specialization; marine coöperative banks are appearing for fishermen in France, Sweden, Norway, and Japan. The urban coöperative banks all adopt the limited-liability plan, issue shares, distribute dividends, and if they succeed at all, tend to become large; many compare favorably in size with American savings banks. They do not combine with one another to form systems for mutual financial assistance; the attempts which have been made in that direction have ended simply in uniting for the discussion and protection of their general interests, except where government has intervened. On the other hand, in the rural districts coöpera-

tive banking tends towards specialization and combination. There is no country where this is not so. The rural coöperative banks, although they may admit any reputable resident to membership, particularly as a depositor, nevertheless utilize their resources exclusively for agriculture, while all become parts of a system formed not only to supply the financial needs of the farmer members, but also to organize their purchasing and selling power, and even to improve their social condition.

The system has three degrees of organization. The first is the local group centering around a rural coöperative bank; the second degree is the regional or provincial unions, each with a central bank and central commercial and industrial associations; the third degree is the federation, with a bank and associations having a national scope. Usually the officers of the federation and its institutions are elected by the unions, the officers of each union and its institutions are elected by adherents composing its various local groups, and the officers of the latter are elected by their individual members. Thus the farmers are organized industrially, commercially, financially, and socially through great decentralized systems officered and supported by themselves and resting upon numerous local coöperative banks. This is the grand purpose of rural coöperative banking; and if it should stop short of this purpose and be content with the creation of detached and isolated associations, the work would be incompletely done. It should aspire to a graduated system of interrelated associations; but no successful system of this kind owes its existence to government intervention. Such a system cannot be established by beginning at the top and trusting to outside assistance of any sort; it must be self-sustaining and decentralized, and built up by the farmers themselves by starting at the grass roots and depending on their own efforts and resources, first assembled in local groups and then combined in regional and national groups, all bound together by unions and federations.

The banks and associations attached to the unions and federations of a rural system are located in convenient towns or cities; they adopt the limited-liability plan, issue shares, and distribute dividends. This plan is adopted also by the local commercial, industrial, or manufacturing associations. Unlimited liability without shares or dividends appears only in the local coöperative banks—and not always there. There are many local groups in which the bank and affiliated associations all limit the liability; but then the territory is large and populous, and its organization similar to a union. The pure associational form is adopted only where the territory is small and the various activities of the members may all be carried on through one association; in this case the association is an unlimited-liability bank. The tendency is to keep the local units small so as to neutralize the risks and make such liability practical; for, the farmers are beginning to realize that the best way to gain the confidence of the public is by showing mutual trust in themselves.

So a typical local rural coöperative bank is an association which has no shares nor any limit to liability, and draws its members from such a small area that all admitted are intimately acquainted with one another. The number of members ranges from fifty to 250, and they may be rich or poor, landowner or tenant, master or servant, so long as they are capable and honest and possess the qualifications prescribed by the articles of agreement. No entrance fees are required on admission or fines or forfeitures exacted on retirement. There may be several banks in the same neighborhood, if the resident population comprises elements that differ sharply in religion, politics, or race; for, the harmony arising from homogeneity and good-fellowship is absolutely indispensable for these

little basic units of the system. They can all find a common meeting-ground in the union or federation; so plurality is rather beneficial, since it keeps the banks small and safe and stimulates a wholesome rivalry among them.

The bank binds each member to conduct all his financial transactions through it and to deposit with it all his available cash; this it redeposits in the associational account in some commercial bank in the nearby city, if the system is not yet formed. It takes savings also from other persons, and may perhaps offer a point above the current interest rate in order to attract deposits and savings. If this does not bring them in adequate volume, it may borrow; and with a group of reputable farmers all personally responsible on its note, it finds no trouble in raising money on the easiest terms. However, it rarely needs to borrow, because the unlimited liability of its carefully selected members affords such a satisfactory guaranty that it is able to carry on its usual operations upon its character credit, or financial standing, if deposits and savings be lacking.

The resources are used for buying farm supplies for cash or on credit in bulk at wholesale to retail to members. The bank may allow members time for payment. It also indorses the notes or accepts drafts executed by members for individual purchases of such supplies, discounts paper they receive in sales of their farm products, and assists them in every banking way in the growing and marketing of their crops. It may even do collective selling. Likewise, it grants money loans, but only for specified productive agricultural purposes. Whatever be the form of credit extended, the term is short and security is taken. The customary period is ninety days, subject to either immediate recall or three or four renewals for good cause shown. The security preferred is one or two indorsers. Long-term loans and real-estate mortgages are avoided and usually forbidden, since the bank aims to keep its funds in circulation for the benefit of members, one and all, and increase its profits by quick and repeated turn-overs of its assets. Banking is easy to learn, says the adage, if one understands what a mortgage is and leaves it severely alone.

The local rural coöperative bank, however, has no lucrative object and it distributes no dividends; but this does not mean that it is a philanthropic society in which the poor are helped at the expense of rich members and all toil for one another without any pay for their work and at less than the ordinary returns for their money. Banking would be impossible with brotherly love carried to such a degree of morbidity. If the bank remains small, its president, directors, and supervisors have of course few duties, and they are proud to perform them for honor. But the secretary-treasurer, who is usually the active manager, is salaried; while all deposits or savings received or sums borrowed, whether from members or non-members, are paid interest at a rate at least as high as prevails in the locality. All these expenses, together with the other costs of business, must be promptly met; so the bank is obliged to charge for services rendered, but it limits its profit-taking to actual necessities. Cheap and efficient service is the reason for its existence. It is not organized for speculative ventures or even for investment. It attracts members, not by appealing to their cupidity, but by affording them a way to economize expenditures and strengthen credit so as to reduce interest rates on loans and better the prices of farm supplies and products. In other words, the chief function of a local rural coöperative bank is to organize the credit of a group of farmers and operate for them through the credit so organized. This is why the bank does not require a cent in entrance fees, share subscriptions, or non-withdrawable deposits or savings.

But there must be a substantial base for the credit. This is accom-

plished by carefully selecting the members and imposing unlimited liability upon them, and then by gradually building out of profits a reserve to protect that liability, strengthen public confidence, and facilitate operations. The entire reserve, or the greater part of it, is indivisible. When once the articles of agreement have declared the indivisibility, the reserve ceases to belong absolutely to either the members or the bank; they cannot individually or collectively apportion any of it among themselves, or obtain its possession by dissolving the bank, since upon dissolution the remainder left after paying debts would pass to its union or to the state for the creation of a similar association in the same place. So the indivisible reserve becomes a local foundation which fixes the bank to the soil and makes it a permanent institution in the neighborhood. Farmers may come and go, but it might continue forever, increasing in strength with the progress of years through the mites contributed by members for benefits received. The prohibiting of dividends prevents members from making individual gains from one another, and preserves in the bank the comradry and good-fellowship that appear in a social club, church, or college; nevertheless, the prohibition of dividends has the very practical reason of accumulating a reserve; so the laws should not forbid or restrict profit-taking in a coöperative bank. This should be regulated by the bank itself.

All coöperative banks have indivisible reserves, and a local rural cooperative bank of the pure associational form carries, with some few exceptions, all its profits to the indivisible reserve. This is logically proper, because a member is not entitled to dividends since there are no shares; moreover, if he be a depositor or borrower, the interest is at the rate to which he agreed; if he is a purchaser of supplies or a seller of products, the prices are the best; if he avails himself of any other facility, the charge is less than he would have paid elsewhere, while he derives a personal advantage from the collective liability that all assume. The bank gives a *quid pro quo* for whatever it takes from him and the other members, and lowers their expenses; so its net earnings go as a right to the reserve. If they were distributed as dividends or rebates, the members would be getting something for nothing; and this idealistic desideratum is as impracticable for a coöperative society as for any other kind of union of persons. The indivisibility, however, does not immobilize the reserve. It stands good for the bank's debts, while the bank may use it in any of its operations just as it uses all its other assets, regardless of source or allocation. Indeed, the reserve (although accumulated out of profits in exactly the converse way to the capital stock of a corporation) is intended for a working as well as a guaranty fund. The larger it grows the less become the bank's needs for outside money. When it equals the capital stock and reserves which a corporation of a similar importance would have, the bank can reduce its profit-taking to the actual cost of business; this is why members of a bank of the pure associational form eventually get cheaper service than members of any other kind of bank.

Moreover, when the reserve has finally reached such dimensions, the unlimited liability of members becomes so safeguarded that it is practically non-existent; for, if the bank should sustain a loss there are many expedients to which it may resort before assessing members. If, for instance, a borrower should default and his property bring nothing on execution, the bank can sue his indorsers. If a deficiency still remained, the bank could raise the interest rate on other loans to cover the loss; they are all subject to recall on short notice. Or, it could increase the selling price of supplies or charge a little more for its banking services. This

would not materially affect members, because the supplies are sold at near the wholesale price and the services are rendered at a lower figure than that of non-coöperative concerns. Thus several steps may be taken before the liability of the members is touched, and they are protected from creditors until the bank has exhausted all its profits and means of increasing its profits, and all its special and indivisible reserves. But this latter contingency is highly improbable, because members are carefully selected, debts or obligations secured, and speculation is forbidden and offers no temptation to the officers, who must bear along with the other members the losses resulting from a risky transaction; while if mismanagement should appear it could not continue, since members have the right of summary dismissal of offending officials and also of dissolving the bank and winding up its affairs if they find it in failing circumstances. This is why failures have rarely occurred of such banks.*

So unlimited liability, absence of share capital, and the allocation of profits to an indivisible reserve instead of their distribution as dividends or rebates are correlative features of a local rural coöperative bank. Its functions transcend the mere gathering-up of members' savings to lend to members, as provided by the so-called credit unions. Confined to this, it would have only a very restricted service, since farmers, as a rule, have no money to lend to one another. An intelligent, capable, and active farmer has uses of his own for all the money he makes; and coöperation enlarges those uses. The savings and loan idea has never appeared among farmers anywhere. No European peasant or American farmer will invest his cash, involve his credit, assume unlimited liability, and work in a coöperative association simply to accommodate borrowing friends. Moreover, there must be something more practical than altruism and more material than the little sum he can save on interest or gain in dividends in order to induce him to undergo all the risks, responsibilities, and burdens imposed by coöperation. The bank grants money loans only out of surpluses that might otherwise lie idle, and uses its funds wherever it is possible for the common good.

Rural coöperative banking has of course a deep significance in respect to each person and place, but when once started its scope and influences continue to spread; for, its grand purpose is to apply to agriculture the best methods of finance, industry, and commerce through local, regional, and national associations combined under unions and federations into a system created, officered, and supported by the farmers themselves for utilizing their collective credit and resources to facilitate the growing and marketing of their crops and afford fair prices to both producer and consumer. The basic units of the system are the local rural coöperative banks; and the closer they adhere to the pure associational form the better they are, since then they must of necessity avoid unwieldy size and remain safe and sound. There is no class of farmers to whom membership would not be an advantage. If for no other reason, the hired hand would find it profitable for his savings; the tenant, effective for strengthening his credit; the large landowner, invaluable for buying his supplies and selling his products. Each would derive benefits in proportion to his money or dealings with the bank, while the mutual responsibility of all for its management and its gradual development into a permanent institution in the neighborhood would create a solidarity of interest among its members and stabilize the rural population around it. Especially would this be so, if its headquarters were made a social center and its meetings, before or after business, the occasion for

* See Myron T. Herrick's *Rural Credits* (New York, D. Appleton and Company)

entertainments, debates, lectures, and discussions, as in Germany. The unlimited liability would be feared no more by the rich than by the poor if the laws contained the proper provisions regarding inspection, publicity, and bankruptcy. The non-profit-paying unlimited-liability associational bank enables members to bring into play all their material and moral worth and to build for the future while mutually helping themselves; it is pure coöperation carried to perfection—the grandest idea ever conceived in coöperation.

But unlimited liability is safe and practical only among groups of intimately acquainted neighbors united in a concern that can operate on their credit as easily as upon their cash. The local rural coöperative bank is such a concern; and so unlimited liability naturally appears in it, but nowhere else in the system. A creamery or packing plant, for instance, requires for its start a certain outlay of money. This can best be obtained by apportioning among the contributors definite parts of the investment; so, although it may be located in the neighborhood and financed entirely by the bank and its members, nevertheless it is an association with shares, and each share involves an obligation to pay only a fixed maximum sum. Wherever an association takes the nature of an investment enterprise or its administration consists of persons other than individual farmers, unlimited liability disappears. In the regional organization, the members of the central industrial and commercial associations are the local banks and associations, and the members of the central bank are both the local banks and associations and the regional associations. They are managed by salaried experts and have variable capital and limited-liability shares. This is also the case with the larger bank and associations that are formed by the combination of lower groups, and so on up to the top. The unions and federations have, of course, no capital or shares, since they do not engage in business or financial affairs. They are formed of the officers of affiliated banks and associations for supervising, directing, and extending the system.

The few systems like this that exist are the results of slow growth, lateral and upward, from the ground. Manifestly the intervention of government or outside parties would violate their principles and interfere with their development. They require members with sufficient self-reliance and ability to depend on their own resources and to organize and govern themselves. Also they require the right kind of legislation. Coöperation thrives best where action through association is legally possible and practically safe, and it can attain its highest usefulness for agriculture only where combination of associations is lawful. In these circumstances coöperation invariably appears wherever there is a need for it; this has been so in America as well as elsewhere. In the United States there are good laws on thrift societies, non-profit societies, social, religious, eleemosynary, scientific, educational associations and the like; and coöperation or mutuality is extensively practiced under them even for large undertakings. The gathering and distributing of news by the American newspapers is the greatest example of coöperation conducted on a grand scale without lucrative object; it enables the news of the world to be placed at the doors of any home in the land at a penny or so a day. The associational life-insurance companies with their millions of policyholders and billions of dollars of assets, and the mutual savings banks and building and loan associations, with their stupendous totals of deposits, savings, and reserves, put most of the funds of organized thrift under coöperative or mutual management, while trade unionism (the oldest form of coöperation) permeates the laboring classes.

These are city-centered, but do not constitute all the coöperative or

mutual activities in America. Coöperation appears in inconceivably varied and innumerable enterprises, and wherever the association is legal, American genius has done more with it coöperatively than has European genius, judged by the actual number of persons and amount of wealth assembled. Contrary to the often repeated assertion, coöperation is peculiarly congenial to the American people, both great and small, in town and country. Farmers' associational organizations for safeguarding mutual interests are numerous. The protection of levees from breaks is in some of the states bordering the Mississippi River an associational coöperative work, while rural economic coöperation for marketing fruits, manufacturing and marketing milk products, and in certain other lines has made notable progress, forcing its way through joint-stock companies, for want of proper laws on associations. The tendency of American farmers to combine has long existed, while signs of the awakening of the true coöperative spirit have begun during recent years to be widely manifest. The free lands that led to abandoning old for new homes and moving where one wished have all been occupied. Farm land is becoming dear and the holding reduced in size. The pioneer, whose thriftlessness received through nature's bounty a surplus to waste, has been replaced by the laborious tiller, whose actual living depends upon the more or less expensive restoration and the careful cultivation of the soil that formerly was so recklessly robbed. Production's costs are so near its returns that economic and scientific methods cannot be neglected without serious losses. The average American farmer today is not the unsettled, isolated, left-over man staying in the country just because he could not live in the town, as so many of his predecessors are depicted. He is a farmer by preference, the best man for the work, and there is nothing in his habits or temperament that is antagonistic to coöperation, while his needs and conditions have finally become such as to make coöperation not only advisable but almost a necessity.

But this does not mean that American agriculture is decadent or even backward; the case is far otherwise. Man for man the American farmer is superior to any other, and he has brought some of the branches of agriculture to the highest development. The public should not forget that the United States has the best system for agricultural education in the world, and that farmers have for years availed themselves of it. Too much praise cannot be bestowed upon the American agricultural departments, colleges, and experiment stations and the splendid work of their able officials, professors, directors, and investigators in modernizing agriculture as a science and an art. The shortcomings of American agriculture lie mainly in the fact that it is unorganized industrially, commercially, and financially; as a result there are expenses, wastages, and losses, that seriously affect the farmers' profits and the consumers' prices. As a larger result agriculture is not keeping pace with the progress being made in other vocations and callings; and in view of the rapid growth in population this will soon or late be detrimental to the country's welfare. The danger, however, is rather imminent than actual. Europe's problem is to remove adverse conditions that exist; ours to prevent them from occurring.

The trouble with American agriculture may then be summed up as lack of organization. Although there are successful exceptions, American farmers, generally speaking, do not use their credit and resources collectively in large groups as do business men and financiers in the cities. They do not systematically help one another. The American farmers should be organized from the plains to tide-water through coöperative systems composed of interrelated associations and based on local rural cooperative banks. There is room enough for two or more such systems,

each expanded to the fifth degree; local, regional, state, departmental, and national. But the laws for forming and governing them are defective, obstructive, or lacking.

What is needed are proper enabling and regulatory laws to authorize associations for profit organized under any form to carry on any kind of business or finance, banking included. These laws should be of a general nature and available for all classes of persons. America is too set in the notion that a concern organized for business or finance should have a capital stock and that all members and investors, except directors and officers, should be free of responsibility and safe from every risk beyond the amount invested in shares or bonds. The very opposite of this appears in an association and it would be all the better for the public if the association were more extensively used. The laws should permit combination of associations for agriculture and small industries, but this would be the only class legislation necessary; for, the farmers and the small producers and the small consumers would have no need of tax exemption, state aid, or special privilege when once they were able to utilize their collective credit and resources. The legislative steps that might be considered are:

An amendment of the National Banking Act so as to permit a national bank that confines its credit facilities to members to be organized as an association of any form without capital stock.

An amendment of the banking act of each state so as to permit any kind of bank that confines its credit facilities to members to be organized as an association of any form without capital stock.

An enabling and regulatory law by the nation and by each state, legalizing for economic associations whatever is lawful for corporations.

A clause in such laws to permit combination among farmers' associations and associational banks, among associations organized for selling food and household supplies to members, and among associations organized by artisans for buying on their common account the materials needed in their work or for selling their products.

But nothing should be done in haste; for the repeal of a law, no matter how bad, often presents serious difficulties. The enactment of proper legislation for rural credits and coöperation would of course be rendered more easy, if there were complete and accurate information at hand about actual conditions. For this purpose, it would be well for the United States Government to have an examination and report made on the present state laws which are available for coöperation or agricultural organization, and which govern building or savings and loan associations, and companies or institutions for according credit to farmers and landowners, including irrigation, drainage, and reclamation projects. The report should also show the facts and figures relating to such organization and concerns that exist, and the amount, interest rates, and terms of the farmers' indebtedness and of real-estate mortgages.

This work might be done through the Census Bureau or by special commissions created by Congress and appointed by the President, but in either case liberal appropriations should be made for it. One million dollars, it will be recalled, were appropriated in 1889 for a somewhat similar investigation. A very much larger sum than this would perhaps now be required to gather the desired information on all subjects mentioned.

END OF
TITLE